FILED
NOV 15 1985
JOSEPH F. SPANIOL, JR.
CLERK

No. 85-504

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

LUNDAY-THAGARD COMPANY,
Petitioner,

v.

UNITED STATES DEPARTMENT OF THE INTERIOR,
Respondent.

On Petition for a Writ of Certiorari to the Temporary Emergency Court of Appeals of the United States

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BRIEF FOR AMICI CURIAE HOWELL CORPORATION; INDUSTRIAL FUEL & ASPHALT OF INDIANA, INC.; DEMENNO/KERDOON, INC.; NAVAJO REFINING COMPANY; TIPPERARY REFINING COMPANY; WESRECO, INC., dba WESTERN REFINING COMPANY, INDUSTRIAL ENERGY PARTNERS, LTD., MM&S PARTNERS, AND ANNA W. DRAKE, TRUSTEE IN BANKRUPTCY FOR WESTERN OIL MARKETING COMPANY; GARY REFINING COMPANY; AND TEXAS AMERICAN PETROCHEMICALS, INC., IN SUPPORT OF PETITIONER

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INTEREST OF AMICI CURIAE

This brief is in support of the Petition for a Writ of Certiorari filed by Lunday-Thagard Company (Lunday-Thagard or Petitioner). *Amici*, like Lunday-Thagard, are small refiners that purchased royalty crude oil from the United States Department of the Interior (Interior) be-

tween 1974 and 1981 pursuant to contracts with Interior. During this period, widespread shortages of crude oil, coupled with spiraling costs, left many small refiners with no source for crude oil other than Interior. Without the availability of such oil, numerous small refiners would have been forced to shut down their refineries.

From April 2, 1974, the Mandatory Petroleum Price Regulations (Price Regulations), 10 C.F.R. Part 212, promulgated by the United States Department of Energy (DOE) pursuant to the Emergency Petroleum Allocation Act of 1973 (EPAA), 15 U.S.C. §§ 751 *et seq.*, provided that the prices charged by "any federal department, agency, or other instrumentality" for the sale of crude oil were subject to the Price Regulations. *See* 10 C.F.R. § 212.52. Moreover, in 1978, Congress confirmed the applicability of DOE's regulations to Interior's sales of crude oil when, in the course of amending the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C.A. §§ 1331 *et seq.* (West Supp. 1985), it inserted several statutory provisions to "provide that the authority of the Secretary of Interior to sell oil is limited by any provision of law in effect, or regulation implementing such law, providing for mandatory allocation and pricing." [1] Thereafter, Interior's standardized contracts were amended to provide that "the price to be paid would be the highest allowable by EPAA." (Pet. App. A at 2a). Hence, Interior, like the private companies in the petroleum industry with which it contracted, was subject to the DOE's Price Regulations.

Despite the above, Interior, which is one of the nation's largest producers of crude oil, made a deliberate decision, at least as early as 1975, to violate the DOE's Price Regulations. Furthermore, as reflected in internal memoranda obtained from Interior and DOE that are reproduced in the Appendix hereto, Interior persisted in

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[1] Joint Explanatory Statement of the Committee of Conference, H. Rep. No. 1474, 95th Cong., 2d Sess. 121 (1978).

its violations of DOE regulations in defiance of the explicit language of the OCSLA amendments and its own contracts, the demands of DOE enforcement officials, repeated advice from its own Solicitor's Office, advice of the Department of Justice, and the entreaties of the small refiners from which it wrongfully exacted overcharges. Unlike the Department of the Navy which in 1976 requested and received an explicit Congressional exemption from the DOE Price Regulations,[2] Interior, during the period of price controls, never attempted to obtain either legislative or administrative relief from the Price Regulations relevant to this case.

Relying on Sections 210 and 211 of the Economic Stabilization Act of 1970 (ESA) as amended, 12 U.S.C. § 1904 note, as incorporated by Section 5(a)(1) of the EPAA, on the Tucker Act, 28 U.S.C. § 1346, and on OCSLA, numerous small refiners, including *amici*, have filed actions before United States district courts against Interior seeking the return of the above overcharges which are estimated by Interior to exceed one billion dollars. Based in part on this Court's decision in *United States v. Mitchell*, 463 U.S. 206 (1983), the district courts have consistently sustained the right of small refiners to bring such actions against Interior and have repeatedly rejected Interior's argument that such actions are barred by sovereign immunity. (Pet. at 17). In its decision below, the Temporary Emergency Court of Appeals (TECA) recognized that a claim of injury has been presented "which on its face appears to call for a remedy" (Pet.

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[2] Following the decision in *Mohawk Petroleum Corp. v. Department of Navy*, 521 F.2d 1394 (Temp. Emer. Ct. App. 1975), that sales of crude oil produced by the United States Department of the Navy were subject to the EPAA and DOE regulations, Congress granted an exemption to the Navy. *See* 10 U.S.C.A. § 7430(b) (West Supp. 1985). A similar exemption was never granted to Interior. Indeed, as noted *infra*, at 7-8, Congress in 1982 explicitly rejected Interior's request for a retroactive exemption and thereby acquiesced in the holding in *Mohawk* that federal agencies were subject to suit.

App. A, at 8a), but nevertheless concluded that no remedy is afforded by the ESA and, by implication, held that the ESA repealed the remedy that otherwise would be afforded by the Tucker Act.

Interior has already seized upon TECA's holding below as the basis for seeking dismissal of certain cases brought by *amici* against Interior.[3] Absent action by this Court, TECA's decision, although demonstrably in error and in conflict with several recent decisions of this Court, will control since TECA has exclusive appellate jurisdiction over appeals from the district courts over issues arising under the EPAA.

SUMMARY OF ARGUMENT

In rendering its decision, TECA applied a method of analysis that was explicitly repudiated by this Court in *United States v. Mitchell, supra*, 463 U.S. at 211-19. That, in and of itself, warrants reversal of the TECA decision.

Moreover, sovereign immunity should not shield Interior from liability for its willful violations of the DOE regulations and the terms of its own contracts. By invoking sovereign immunity against Petitioner, TECA acted contrary to the clear intent of Congress expressed in the Tucker Act, in the 1978 amendments to OCSLA, and in 1982 royalty management legislation.

The Tucker Act unequivocally waives sovereign immunity with respect to commercial activities, such as those which are the subject of this suit. The 1978 amendments to OCSLA permit "citizens suits" arising out of violations of DOE's Price Regulations to be brought against "any person, including the United States, and any other govern-

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[3] Based on the Lunday-Thagard decision, the United States District Court in Tipperary Refining Company v. United States Department of the Interior, No. MO-84-CA-05, W.D. Tex., by order filed October 9, 1985, reversed its prior order and dismissed all of Tipperary's claims except that involving transportation charges. *See Amici* App. B at 78a.

mental instrumentality or agency" without restricting any other right the citizen "may have under any other Act or common law to seek appropriate relief." Finally, in 1982 Congress specifically rejected proposed legislation that would have barred small refiners from bringing actions against Interior based on Interior's past violations of DOE's regulations, and instead adopted legislation that dictates how Interior's liabilities for overcharges are to be shared by Interior with the States.

By these actions, Congress has expressed its unambiguous intent that Interior be held accountable for its refusal to comply with the DOE's Price Regulations. In short, there is no need for small refiners to "look to Congress for relief" as TECA has suggested (Pet. App. A at 8a); Congress has already spoken. TECA's ultimate conclusion (Pet. App. A at 8a) that the small refiners are without a remedy is in fundamental conflict with the above expressions of congressional intent and should be reversed.

The failure of the appeals court to recognize the distinction between the "governmental" and "proprietary" functions performed by Interior (Pet. App. A at 5a-6a) is both misleading and unnecessary to the resolution of the controversy. Indeed, because all of Interior's sales of crude oil were made pursuant to written contracts, as is customary with most commercial transactions, the decision below shielding Interior from liability arising out of its contractual activities is flatly inconsistent with the Tucker Act, which has long waived sovereign immunity for all contract claims.

Given the serious consequences of TECA's decision and the substantial harm that will be realized by the small refiners if they are denied their day in court, it is imperative that the decision be subjected to review by this Court. Indeed, the fundamental conflict that exists between TECA's decision and several recent decisions of this Court strongly suggests that summary reversal may be appropriate.

ARGUMENT

I. The Doctrine Of Sovereign Immunity Should Not Insulate Government Agencies From The Consequences Of Violations Of The Law In Their Commercial Dealings.

"[T]he stated purpose of the doctrine [of sovereign immunity] is to protect *government functions*, not merely to protect the government." (Emphasis in original). *Wesreco, Inc. v. United States Department of the Interior*, C-84-0126J (D. Utah April 12, 1985), slip op. at 28, *citing Larson v. Domestic & Foreign Corporation*, 337 U.S. 682, 704 (1949).[4]

Sovereign immunity should not shield a government agency acting in a commercial context from liability arising out of violations of regulations promulgated by another agency. It is an ancient axiom that when government "comes down from its position of sovereignty and enters the domain of commerce, it submits itself to the same laws that govern individuals there." *Cooke v. United States*, 91 U.S. 389, 398 (1875). This is especially true here, where the regulations—and the laws under which they were promulgated—were intended to regulate the very activities in wl ich Interior was engaged, and where Interior officials acted with full knowledge of the unlawfulness of their activities and the consequences flowing therefrom.

TECA's refusal to enforce compliance with the EPAA and the DOE's Price Regulations has frustrated the unquestioned governmental function of enforcing the EPAA and DOE's regulations. As the *Wesreco* court recognized (slip op. at 34-35), Congress sought to promote enforcement of the EPAA "by allowing every person suffering legal wrong to act as a private Attorney General under §§ 210 and 211" of the ESA. Also, by specifically con-

[4] A copy of the *Wesreco* opinion has been lodged with the Court by Petitioner.

firming that Interior's authority to sell crude oil was subject to, and limited by, the EPAA and DOE's regulations, and by authorizing citizens suits for damages against Interior under Section 23 of OCSLA, Congress clearly indicated its intention to enforce compliance through private actions against Interior.

Furthermore, TECA's decision to immunize Interior from liability conflicts with recent congressional pronouncements that implicitly acknowledge a waiver of sovereign immunity. In the course of its deliberations involving the Federal Oil & Gas Royalty Management Act of 1982 (FOGRMA), Congress pointedly rejected language proposed by Interior that "would have provided the Department of the Interior with an absolute defense against lawsuits alleging that the Department sold royalty crude oil taken in-kind at prices not permitted under Department of Energy regulations implementing the Emergency Petroleum Allocation Act of 1973." S. Rep. No. 512, 97th Cong., 2d Sess. 11-20 (1982).[5] Instead, Congress specified the manner in which States are to be assessed their "share of an overcharge, resulting from" any failure by Interior "to comply with the [EPAA] or regulation of the Secretary of Energy thereunder concerning crude oil certification or pricing with respect to crude oil taken by the Secretary in kind as royalty," and prohibited Interior from assessing States any portion of any interest or penalties charged against Interior as a result of such violations. *See* 30 U.S.C.A. § 1721(e) (West Supp. 1985). Both of these provisions would be superfluous if Interior

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[5] Interior included a bid for legislative amnesty in Section 12 of the original "Federal Energy and Mineral Resources Act of 1982" that it sent to Congress. The Senate, however. substituted its own text in which it made the substantive changes relied upon by *amici* herein that were ultimately enacted as part of FOGRMA, P. Law No. 97-451, 96 Stat. 2448 (1983), as codified at 30 U.S.C.A. §§ 1701 *et seq.* *See* S. Rep. No. 512, *supra*, at 11-20.

were immune from suit under the EPAA and the DOE regulations.[6]

The Congress was fully aware of the many actions already pending in the district courts challenging the lawfulness of Interior's actions when it inserted the above provisions. Indeed, the necessity for their inclusion was predicated on the Senate's concern that overcharges may result from decisions made during the period of price controls "by employees of the Department of the Interior about compliance with the price and allocation rules" promulgated by DOE. S. Rep. 512, *supra*, at 16.

The Interior employees' decisions, referred to by the Senate, not to comply with DOE regulations are documented in memoranda and other correspondence. These

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[6] In declining to grant Interior amnesty or immunity from suits brought by small refiners, Congress repeated its concern, set forth in every major piece of energy-related legislation in the 1970's, that small refiners be protected. Congress' recognition of the plight of the small refiners was perhaps most explicitly stated in 1973 when, in the course of enacting the EPAA, Congress "offer[ed] a mantle of protection to those refiners who by reason of their relatively small size may be disadvantaged in competing with larger refiners in bidding for and obtaining adequate crude supplies." H. Rep. No. 628, 93rd Cong., 1st Sess. 17 (1973). *See* EPAA § 4(b)(1)(D), 15 U.S.C. § 753(b)(1)(D). The continuing congressional intent to protect small refiners is reflected in Acts that amended and supplemented EPAA. *See* Energy Policy and Conservation Act, Pub. L. No. 94-163, 89 Stat. 871 (1975), section 403, as codified at 15 U.S.C. § 753(e), which amended DOE's entitlements program to relieve small refiners of a portion of the financial burden resulting from application of that program as originally enacted; Energy Conservation and Production Act, Pub. L. No. 94-385, 90 Stat. 1125 (1976), which, in section 123, expressed the intent of Congress to foster "construction of new refineries by small and independent refiners in the United States"; and Section 27 of OCSLA, 43 U.S.C.A. § 1353(b) (West Supp. 1985), which provided for allocation of royalty oil to small refiners.

documents, some of which have been reproduced in the Appendix hereto, track Interior's deliberate violations of DOE regulations throughout the period of price controls.[7] While Interior officials were fully aware, at least as early as May 1975, that Interior's procedures governing the sale of royalty oil failed to comply with DOE's Price Regulations, they chose not to implement an available procedure that would have brought them into compliance "because of the additional workload involved" and because Interior could foresee "no internal benefits". (*See Amici* App. at 1a-2a). In memoranda dated March 17, 1976 and April 19, 1976, Interior operations personnel noted that "[i]f we do not follow the [DOE] regulations, we violate the law", and requested guidance from Interior's Office of the Solicitor with respect to the conflict. (*Amici* App. at 5a). These memoranda also reflect that DOE auditors had already advised Interior that its practices violated DOE's regulations and that such violations resulted in royalty oil purchasers "paying royalties on prices that exceed the posted prices allowed by [DOE] regulations." (*Id.* at 11a-12a). In responding to the requests for legal advice, Interior's Assistant Solicitor concluded, as its operations personnel and the DOE auditors had, that DOE's regulations applied to prices charged by federal agencies. (*Id.* at 18a). In a later memorandum dated August 23, 1976, the Assistant Solicitor unequivocally advised operations personnel again that in "the sale of royalty oil, the valuation and billing for that oil is subject to the [DOE] regulations" and thus, "the valuation of royalty oil cannot exceed the ceiling price set by the [DOE's] regulations." (*Id.* at 18a).

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[7] These documents have been released by Interior and DOE pursuant to FOIA requests. In many instances portions of the documents were excised prior to their release. Also, many contain handwritten interlineations. Because it is impossible to reproduce these interlineations in the Appendix, a complete photostatic set of the documents has been lodged with the Court.

Throughout this period, DOE repeatedly advised Interior that it was in violation of the Price Regulations, and, as a result, was charging prices in excess of the ceiling price permitted by DOE's regulations. In a May 197[illegible] memorandum recording the substance of a meeting between Interior representatives and DOE enforcement officials, a senior DOE attorney recounted that DOE had advised Interior that "[t]hese violations appeared to be clear cut and extremely troublesome to [DOE], given [DOE's] mandate from the Congress to impose regulations on all crude oil produced in or imported into the United States." (*Id.* at 20a). Following this meeting, DOE's Deputy General Counsel for Enforcement requested that Interior provide a written justification for its disregard of DOE regulations in order to resolve the dispute between the two agencies "which continues to plague the enforcement operations of [DOE]." (*Id.* at 22a). Absent such justification, the DOE officials concluded, DOE would "have no choice but to proceed against [Interior] in the context of a formal compliance action." (*Id.*).

In response to DOE's request, Interior's Solicitor issued a memorandum in October 1977 to DOE's chief law enforcement official which, in direct conflict with the 1976 internal memoranda, purported to challenge DOE's authority over Interior's valuation of royalty oil. (*Id.* at 49a). This memorandum, which was Interior's only formal attempt to rationalize its violations, did not persuade DOE, which continued to assert that Interior must comply with the DOE's regulations or be subjected to enforcement proceedings. (*See id.* at 54a, 55a-56a, and 57a-60a).

DOE was not alone in its position. A 1981 Interior memorandum states that "[o]n at least one occasion the Department of Justice suggested that our position [as expressed in the October 1977 memorandum] was not legally defensible." (*Id.* at 61a). Indeed, upon further

review by a staff attorney in Interior's Solicitor's Office, both the reasoning and the conclusions expressed in the October 1977 memorandum were judged to be "not legally supportable" and lacking "adequate legal or factual justification." (*Id.* at 66a-67a).[8]

Having failed in its attempt to dissuade DOE, Interior nevertheless continued to violate the regulations throughout the period of price controls. This course eventually provoked the Director of DOE's Office of Enforcement to advise Interior that DOE was "bringing criminal charges against certain private oil companies for violating DOE's pricing regulations, and the companies are asserting as a defense [Interior's] pricing behavior." (*Id.* at 68a). The DOE Director of Enforcement (*id.*) also advised Interior:

> . . . the federal government is going to look absolutely terrible and DOE's prosecutions of flagrant behavior by private individuals is [sic] going to be hampered by the failure to resolve [the issue of Interior's unlawful pricing behavior]. . . . [Interior] and DOE both may well end up with a serious black eye if the situation is not resolved soon.

Although Interior was able to forestall DOE from bringing an enforcement action against it,[9] it was unable to prevent small refiners from exercising their rights

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[8] In any event, the basic assumptions and conclusions stated in this memorandum were undercut by the 1978 Amendments to OCSLA which explicitly made Interior's sales of crude oil subject to DOE's regulations.

[9] As noted in an article concerning Interior's violations, "[f]ederal energy regulators threatened to file formal overcharge allegations in court against the Interior Department several times, but they never carried out the threat." As the article continues, "'[t]he U.S. government doesn't often sue itself,' says Thomas Newkirk, a deputy general counsel of the Energy Department. He suggests that political pressure and jurisdictional squabbling thwarted aggressive and timely enforcement action." Pasztor, Lawsuit Alleges Interior Officials Violated Federal Oil Price Controls, Wall St. J., June 13, 1984, at 31, col. 4.

under Section 210 of the ESA "to act as a private Attorney General." *See Wesreco*, slip op. at 34. As Interior's correspondence with the Department of Justice reveals, Interior was caught in a bind. While it did not want to take the chance that a federal court might rule against it, it nevertheless was reluctant to settle since it recognized that other suits by small refiners would follow. (*Amici* App. at 69a-74a).

Instead of altering its practices to comply with the law, Interior turned its attention to devising a scheme that would permit it to evade liability. As explained in a May 16, 1980 memorandum, Interior fashioned a multipronged approach which included asking the "Department of Justice as a delaying tactic to adopt a position based on the [October 1977] memorandum that the Department of the Interior is not bound" by the relevant regulatory requirements. (*Id.* at 75a). Other alternatives included seeking "a legislative exemption" from the DOE's pricing regulations—a step which was initiated in 1982, more than one year after DOE's regulations had been revoked and which, as noted *supra*, was ultimately unsuccessful.

The May 16, 1980 memorandum also suggested that an exemption be sought from DOE—a step that was not taken until mid-November 1982, well after expiration of the Price Regulations. Critical to DOE's approach was its realization (*id.* at 77a) that such an approach was necessary because "*we cannot expect Justice to continue to defend* [Interior] *in future cases.*" (Emphasis added.)

In summary, Interior was aware from the outset that its sales of crude oil were covered by the DOE's regulations. However, with absolutely no justification, Interior deliberately refused to comply with those regulations. Even after being advised by the highest ranking DOE enforcement officials and its own legal officers that its conduct was in clear violation of the law, Interior re-

fused to alter its course, and instead adopted a policy of obstruction designed to defeat the small refiners' private enforcement actions and to avoid the wholly foreseeable consequences of its knowing and willful unlawful conduct.

TECA's elimination of the private enforcement actions that have proved to be the only effective means of assuring the integrity of the legislation against Interior's violations stands the purpose of sovereign immunity on its head. By permitting Interior to hide behind the shield that it has fashioned, TECA has not advanced the "governmental function" of enforcing the congressional mandate "to impose regulations on all crude oil produced in . . . the United States." (*Amici* App. at 20a). Instead, TECA has protected one of the largest and most flagrant violators of the DOE Price Regulations from liability and has disregarded Congress' intent to make Interior accountable to small refiners for its unlawful activities.

II. The Decision Below Erroneously Disregarded The OCSLA.

TECA's conclusion that sovereign immunity shields Interior's violations of the DOE's regulations is in fundamental conflict with OCSLA and the independent waiver of sovereign immunity provided thereby. Although TECA conceded (Pet. App. A. at 2a, n.1) that OCSLA is applicable to Interior's sale of royalty oil, it disregarded the clear recognition in the 1978 Amendments to that Act that sovereign immunity had been waived. Section 27 of the OCSLA, codified at 43 U.S.C.A. § 1353(b) (West Supp. 1985), contains an express reference to the Secretary of Energy and specifically confirms that Interior's sales are subject to the Price Regulations,[10] while Section

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[10] As previously noted (at 2), the DOE's Price Regulations specifically applied to prices charged by "any federal department, agency, or other instrumentality" for the sale of crude oil. Under DOE's initial regulations, sales by federal departments and agencies had been exempted. 10 C.F.R. § 212.52(a), 39 Fed. Reg. 1924

23, codified at 43 U.S.C.A. § 1319(e) (West Supp. 1985), expressly authorizes citizens' suits against Interior, thereby confirming the waiver of sovereign immunity with respect to such actions. Also, without restricting any rights that any person "may have under any other Act or common law to seek appropriate relief," [11] Congress expressly vested the district courts with jurisdiction over civil actions "against any person, including the United States, and any other government . . . agency," [12] involving violations of OCSLA, including jurisdiction to award reasonable attorney and expert witness fees.

Interior was aware that the 1978 OCSLA Amendments applied to its sales of crude oil and it promptly amended its standardized contracts to reflect these amendments. While it thus confirmed the nexus between its sales and DOE's regulations, it nevertheless continued to violate those same regulations.

Plainly, when Interior sold royalty oil without complying with EPAA and the DOE's Price Regulations, it not only breached its contracts, but it violated the provisions of Section 27 of OCSLA and thereby subjected itself to the relief granted by that Act to any person having a

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(1974). Because DOE determined that it would be inequitable to exempt federal agencies, the exemption was repealed effective April 2, 1974. 10 C.F.R. § 212.52, 39 Fed. Reg. 12252 (1974). Thereafter, Congress extended the EPAA and amended it on several other occasions. However, in stark contrast with the exemption extended by Congress in 1976 to the Department of the Navy, Congress never questioned DOE's repeal of the exemption with respect to Interior. *See* Act of Dec. 5, 1974, Pub. L. No. 93-511, 88 Stat. 1608; Emergency Petroleum Allocation Act of 1975, Pub. L. No. 94-99, 89 Stat. 481; Act of Nov. 14, 1975, Pub. L. No. 84-133, 89 Stat. 694; Energy Conservation and Production Act, Pub. L. No. 94-385, 90 Stat. 1125 (1976); Energy Security Act, Pub. L. No. 96-294, 94 Stat. 611 (1980); *cf.* note 2, *supra*.

[11] 43 U.S.C.A. § 1349(a)(6) (West Supp. 1985).

[12] *Id.* at § 1349.

valid legal interest that was adversely affected. This would include small refiners whose contracts with Interior recite the provisions of Section 27 of OCSLA linking the "regulated price" of the contract to the EPAA and the DOE's rules and orders issued thereunder.

III. By Invoking Sovereign Immunity In This Case, The Decision Below Is In Fundamental Conflict With *Mitchell*, The Tucker Act, And The Contrary Position Asserted Before This Court On Behalf Of Interior In *Mitchell*.

The claims asserted by Petitioner and *amici* clearly fall within three express categories of claims cognizable under the Tucker Act—those founded upon "any express . . . contract with the United States," those founded upon "any Act of Congress," and those founded upon "any . . . regulation of an executive department." While the decision below superficially focuses on the claims founded upon the EPAA and DOE's Price Regulations, the court's analysis ultimately disregards the simple breach of contract claims raised by Petitioner and *amici* arising out of Interior's failure to honor its contracts in which it agreed to comply with the EPAA and DOE regulations.

TECA's analysis blurs the distinction between the concepts of jurisdiction, cause of action and sovereign immunity, and otherwise fails to recognize the distinction between governmental and commercial activities. A glaring example of this is TECA's misapplication of *Federal Crop Insurance Corporation v. Merrill*, 332 U.S. 380 (1947)—a case recognized to be the seminal estoppel case involving the federal government.[13] Claiming that *Merrill* eliminated the "distinction between the regula-

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[13] *Merrill* did not involve a claim of sovereign immunity; indeed this Court acknowledged (332 U.S. at 382) that it was "appropriate" that suit had been brought in the state court. The holding in *Merrill* is simply that the rules of law whereby private insurance companies are rendered liable for the acts of their agents are not readily applicable to a governmental agency.

tory and private functions of the government" (Pet. App. A at 6a), TECA rejected the holdings of several district courts that Interior is subject to suit by small refiners because it was engaged in purely commercial activities. Not only is this result not supported by *Merrill*, but it is in clear conflict with the precedent of the Court of Claims. *See, e.g., Ottinger v. United States*, 116 Ct. Cl. 282, 285, 88 F. Supp. 881, 883 (1950).

More to the point, however, all of Interior's activities at issue here were conducted pursuant to written contracts with Petitioner. This should have ended TECA's inquiry; as this Court recognized in *Mitchell* (463 U.S. at 215), the "existence of a waiver is readily apparent in claims founded upon 'any express . . . contract with the United States'."

TECA, however, rejected (Pet. App. A at 6a-7a) the conclusion, reached by several district courts, that *Mitchell* has "dictated the existence of a waiver in EPAA cases." After quoting this Court's preliminary statement (463 U.S. at 212) that "by giving the Court of Claims jurisdiction over specified types of claims against the United States, the Tucker Act constitutes a waiver of sovereign immunity with respect to those claims", TECA dismissed *Mitchell* with the off-hand comment that "*Mitchell* does not apply because the whole purpose of the Tucker Act . . . is to permit suit against the United States" while the "EPAA merely speaks of 'persons' who may sue or be sued." (Pet. App. A at 7a).[14]

In addition to being factually incorrect—the EPAA does not speak of "persons" who may "be sued"—TECA's

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[14] TECA's assertion that "*Mitchell* does not apply" is also premised on its conclusion that its own decision in McCulloch Gas Processing Corp. v. Canadian Hidrogas Resources, Ltd., 577 F.2d 712 (Temp. Emer. Ct. App.), *cert. denied*, 439 U.S. 831 (1978), "controls this case." (*See* Pet. App. A at 5a). TECA's analysis in *McCulloch*, however, is based on this Court's suggestion in United States v. Testan, 424 U.S. 392, 398, 400 (1976), which was rejected in *Mitchell* (362 U.S. at 216), that the Tucker Act does not

attempt to distinguish *Mitchell* is baseless. It ignores the sweeping language in *Mitchell* (463 U.S. at 218) that a court "need not find a separate waiver of sovereign immunity" with respect to claims against the United States "founded either upon . . . any Act of Congress, or any regulation of an executive department," or based on "any express contract . . . with the United States." Since Petitioner's claims, and those of *amici*, are within the categories of claims described in the Tucker Act, "the waiver of sovereign immunity is clear." Hence, TECA should not have added to the rigors of sovereign immunity faced by Petitioner and should have limited its inquiry, as required by *Mitchell*, to two issues:

1) Whether the EPAA "can be interpreted as requiring compensation." It should be noted that the district courts that have properly followed this Court's directions in *Mitchell* have concluded that small refiners may rely on Section 210 of the ESA and the DOE's Price Regulations as the basis for their substantive right to obtain money damages. *See Wesreco*, slip op. at 21-22 and cases cited at 25; and Pet. at 15-17.

2) Whether Petitioner has otherwise stated a claim based on an express contract with the United States, which it clearly has.

TECA (Pet. App. A at 7a) further seeks to avoid the holding in *Mitchell* with the non-sequitur that "[t]he claim here does not fall within the Tucker Act because Section 211 places jurisdiction of EPAA claims in the district courts." TECA has posed the wrong inquiry. Even though the ESA placed exclusive jurisdiction in the district courts, this did not repeal Petitioner's Tucker Act remedies. *See Regional Rail Reorganization Act Cases*, 419 U.S. 102, 125-36 (1974). Petitioner has cor-

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serve as a broad waiver of sovereign immunity. *McCulloch* thus, in this respect, is in irreconcilable conflict with this Court's subsequent decision in *Mitchell*. *Mitchell*, not TECA's earlier decision, controls this case.

rectly observed (Pet. at 11) that the ESA and the Tucker Act are capable of co-existence. By simply recognizing ESA as a waiver of the Tucker Act's $10,000 jurisdictional limit, TECA could have avoided the artificial conflict it created.

Putting the above to one side, the position taken in this case by both TECA and Interior directly contradicts the unambiguous position previously taken before this Court by Interior in *Mitchell*. Petitioner and *amici* claim, among other things, that Interior has unlawfully exacted their own money by overcharging them for the crude oil they purchased from Interior. This Court stated in both *United States v. Testan*, *supra*, 424 U.S. at 401-02, and in *United States v. Mitchell*, *supra*, 463 U.S. at 223 n.23, that there is "undoubted consent to suit" regarding such claims. *See Eastport Steamship Corporation v. United States*, 178 Ct.Cl. 599, 605-06, 372 F.2d 1002, 1007-08 (1967).[15]

Recognizing the continuing vitality of this rule, Interior conceded in *Mitchell* that:

> Where suit is maintained to require the United States to disgorge a claimant's "money improperly exacted or retained," the statutory predicate need not specify that a right of action for damages is created.

See Brief for the United States at 24 (No. 81-1748).

Furthermore, as this Court noted in *Mitchell* (463 U.S. at 223 n.23), Interior also "assumed" in that case:

> . . . that an action to recover unlawfully high administrative fees may be maintained against the United States as one seeking recovery of "money improperly

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[15] The right of the citizen to recover his own money wrongfully exacted by government officials substantially predates the Tucker Act and is not open to question. *See* Bank of the United States v. Bank of Washington, 30 U.S. (6 Pet.) 8 (1832); United States v. Lee, 106 U.S. 196 (1882); Swift and Courtney and Beecher Co. v. United States, 111 U.S. 22, 29-31 (1884).

> exacted or retained." *United States v. Testan, supra,* 424 U.S. at 401.

Brief for the United States at 33 n.27.

Subsequently, Interior argued that:

> *Eastport Steamship Corp. v. United States, supra,* which was also the basis for the relevant discussion in *Testan, supra,* states unequivocally that claims within this category . . . "must assert that the value sued for was improperly paid, exacted, or taken from the claimant *in contravention of the Constitution, a statute or a regulation.*" Thus, as we noted in our opening brief (page 24, n.17), a statutory basis must be identified that establishes the wrongfulness of the exaction or nonpayment.

Reply Brief for the United States at 7-8 (No. 81-1748), (emphasis added by Interior; citation omitted).

TECA's inexplicable holding that Petitioner is barred from a suit to recover its own money and from recovering its damages resulting from Interior's breach of contract thus conflicts with the very position Interior asserted in *Mitchell,* and with a long and heretofore unquestioned line of decisions of this Court. This, in addition to TECA's total disregard for this Court's reasoning in *Mitchell,* compels the reversal of the decision below.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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Anna W. Drake, Trustee in
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Marketing Company; Gary
Refining Company; and Texas
American Petrochemicals, Inc.
et al.

Dated: November 15, 1985

APPENDICES

APPENDIX A

Memorandum [May 15, 1975]

To: Area Oil and Gas Supervisor, Northern Rocky Mountain Area

Through: Conservation Manager, Central Region

From: Chief, Conservation Division

Subject: Applicability of FEA regulations (10 CFR 212.131) to USGS as a "seller" of royalty oil

In answer to your memorandums of December 23, 1974, and April 25, 1975, we have reviewed 212.131 of Part IV of the *Federal Register* dated December 14, 1974, and have had discussions with FEA representatives. Based on this review, we have concluded that under these regulations the USGS should be considered as a seller of oil.

The following procedures should be put into effect immediately by all Area Oil and Gas offices having royalty oil contracts:

A. For a given month, establish the average price paid for old and new crude oil sold in the area. For each royalty oil contract, divide the royalty value by the royalty quantity to determine the average price paid for the oil taken that month. The contract royalty value and royalty quantity are shown in the ADP printout "ROYALTY TAKEN IN KIND."

If we use Casper's "RIK CODE 18 CONTRACT" for the month of February 1975 and assume average area prices of $5.35/bbl. and $10.15/bbl. for old and new oil, respectively, we may use the royalty quantity of 78,923.85 barrels and the royalty value of $544,490.71 to make the following calculations:

1. $$\frac{\$544,490.71}{78,923.85} = \$6.8989/\text{bbl.}$$

If the average price calculated is $5.35 per barrel or less, then all the oil for this contract may be considered as old oil, and no further calculation is needed.

2. Let x=percent of old oil x+y=1
Let y=percent of new oil y=1—x

then, —illegible—

$5.35x+10.15y=6.8989$
$5.35x+10.15(1-x)=6.8989$
$5.35x+10.15-10.15x=6.8989$
$4.80x=-3.2511$
$x=.6773$ or 67.73%
$y=1-x$ or $1-.6773=.3227$ or 32.27%

Thus, old oil sold under the contract for the month is $78,923.85 \times .6773 = 53,455.12$ barrels, and new oil sold amounts to $78,923.85 \times .3227 = 25,468.73$ barrels.

3. Enclosed are EXHIBIT A, showing how the above would be reported on a monthly form, and EXHIBIT A1, showing the ADP "ROYALTY TAKEN IN KIND" printout for RIK 18. Also, enclosed are a few of the blank forms entitled "REPORT ON OLD, NEW, RELEASED AND STRIPPER WELL OIL" that may be reproduced and used in reporting each month to the royalty oil purchasers.

We realize that this procedure of estimating old and new oil does not accurately reflect the old and new oil volumes because of the correction of earlier charges and variations in oil pricing. In addition, this new report will be filed after receipt of the ADP printouts of "ROYALTY TAKEN IN KIND" and will not meet the FEA's deadline. The only other practical procedure for reporting old and new oil would be to separate the input for old and new oil by using an ADP source code for the new

oil. For example, source code 565 shown on the enclosed EXHIBIT A1 could be N65 for new oil, and the regular source code could be maintained for old oil. However, we do not intend to use this procedure unless it is required at a later date because of the additional workload involved and the fact that no internal benefits result from either procedure.

/s/ Russell S. Wayland
Chief, Conservation Division

Enclosures

cc: RCM—Denver
Menlo Park
Metairie
Washington, D.C.

Area Oil and Gas Supervisors

Los Angeles	Tulsa
Metairie	Anchorage
Roswell	Washington, D.C.

OS&D—Denver
CD—Royalty oil contract file (onshore general)
Harris 501-6
EWyatt:WMHarris:05/08/75

UNITED STATES DEPARTMENT OF THE INTERIOR

GEOLOGICAL SURVEY
434 Imperial Office Bldg., 3301 N. Causeway Blvd.
P.O. Box 7944
METAIRIE, LOUISIANA 70011

Tel: (504) 837-4720

March 17, 1976

Memorandum

To: Chief, Conservation Division

Through: Conservation Manager, Gulf of Mexico OCS Operations

From: Oil and Gas Supervisor, Production Control, GMA

Subject: Oil and Condensate Pricing Conflict between FEA and DOI Regulations

Federal Energy Administration Regulations in 10 CFR 212.52, Sales by Federal, State, or local governments, state that "The prices charged for any sale of a covered product by any Federal department, agency, or other instrumentality*** are subject to the price regulations of this part". We have received price bulletins from major producers of crude oil in the Gulf of Mexico Area showing prices for oil in this area effective February 1, 1976, at $5.35 and for new oil $11.53, in compliance with FEA regulations.

We previously have established values under 30 CFR 250.64, many of which were used in valuing oil and billing small refiners under royalty oil contracts. These prices sometimes reflected transportation allowed as a deduction and gathering as an increase in value. We are presently faced with a problem, exemplified by the Rock Island Refinery Corporation royalty oil contract, in which

the differential in amount under our contract and under FEA regulations effective February 1, 1976, is about $20,000 a month. The problem is complicated by the fact that many commingling approvals have established values for the producer/operator which have been carried over to royalty oil contracts; but in many cases no transportation allowance is granted to royalty oil purchasers for the one-sixth royalty interest sold.

If we abide by the FEA regulations we are in violation of 30 CFR 250.64, pertaining to gross proceeds. If we do not follow the FEA regulations, we violate the law.

Please request a solicitor's opinion as to whether our commingling approvals which have been written establishing a value in excess of posted prices (in most cases by adding a gathering allowance) are still legal and applicable, particularly to royalty oil sold under our title 30 CFR 225a regulations.

/s/ LOUIS E. MCBEE
for J.B. LOWENHAUPT

cc: 1.39—Rentals and Royalty
1.39.2—Royalty Oil—General
Accounting 18

GBWoodward:pg

Apr. 19, 1976

Memorandum

To: Assistant Solicitor—Minerals
Division of Energy and Resources

From: Chief, Conservation Division

Subject: Conflict Between Federal Energy Administration (FEA) and Department of the Interior (DOI) Regulations Regarding Oil and Condensate Prices

By Memorandum of March 17 (copy enclosed) from our Metairie office, we were advised of an apparent conflict between the FEA regulations (10 CFR 212.52) and DOI regulations (30 CFR 250.64) regarding oil and condensate prices. Enclosed for your convenience is a copy of the *Federal Register* of February 3, 1976, that includes 10 CFR 212.52 on page number 4939 and an EXHIBIT I that shows 212.52 (FEA), 250.64, and 221.47 (DOI) relative to the value basis for computing royalties.

The second sentence of both the offshore (30 CFR 250.64) and the onshore (30 CFR 221.47) regulations states "Under no circumstances shall the value of production of any of said substances for the purpose of computing royalty be deemed to be *less* than the gross proceeds accruing to the lessee from the sale thereof or less than the value computed on such reasonable unit value as shall have been determined by the Secretary." The FEA regulations, 10 CFR 212.52, state that the prices charged for any sale of a covered product by any Federal department or agency are subject to the price regulations herein.

Are we now prohibited from calculating royalties on the gross proceeds accruing to the lease should that value exceed the FEA regulations? In order for us to carry out our responsibilities in accordance with the regulations, we need your immediate legal advice.

The following pertains to some of the problems involved in computing royalties on prices that exceed FEA regulations, retroactive adjustments, etc.:

A. According to the memorandum of March 17 from the Oil and Gas Supervisor, most commingling approvals have been written establishing a value in excess of the posted prices (in most cases by adding a gathering allowance). The current price bulletins for the Gulf of Mexico Area show the oil prices as $5.35 for old oil and $11.53 for new oil, effective February 1, 1976, which are in accord with FEA regulations. Enclosed is the February 1976 Lessee's Monthly Report of Sales and Royalty for lease No. OCS-G-1449 that shows the lessee reported an old oil price of $5.33 per barrel and a new oil price of $11.51 ($5.33 plus $6.18) per barrel. The report also shows a gathering allowance (additional payment) of $0.055 per barrel and a transportation allowance of $0.079826 per barrel. Under the Royalty Quantity column, the report shows that 65,482.32 royalty barrels are taken in kind and sold under royalty oil contract and 2,086.47 royalty barrels are paid for by the lessee. For the royalty oil taken in kind, no transportation allowance is granted because the point of delivery is at the lease, and we have billed the royalty oil refiner at $5.385 ($5.33 plus $0.055) per barrel or $0.035 ($5.385 minus $5.350) per barrel in excess of that permitted by FEA. Also, we have billed the royalty oil refiner at $11.565 ($11.51 plus $0.055 gathering allowance) for the new oil per barrel or $0.035 ($11.565 minus $11.53) per barrel in excess of that permitted by FEA. The lessee's billing is in effect the same as for the royalty oil contract, except the transportation allowance of $0.079826 reduces the price to $5.305174 for old oil and $11.485174 for new oil, neither of which exceeds the prices allowed by FEA regula-

tions. The fact that royalties are being paid by the lessee on a price less than the maximum set by FEA, due to a transportation allowance, does not preclude us from being in violation of the FEA regulations.

Also enclosed are two actual "Summary of Deliveries" from Placid Oil Company to our Metairie office for February 1976. One is for Eugene Island Blocks 296 and 306 that shows the calculation of the oil and condensate net price as $11.7507 ($11.7079 gross price) per barrel for lease Nos. OCS-G-2105 and 2109. This amounts to $0.2207 per barrel more than permitted by the FEA regulations, and oil from lease No. OCS-G-2105 is sold under royalty oil contract. The other summary is for South Marsh Island Field 269 and shows an average net price calculation of $11.7398 ($11.5863 gross price) per barrel applicable to lease Nos. OCS-G-2310, 2311, and 2600. This amounts to $0.2098 per barrel more than permitted by FEA regulations. Said increases are due to pipeline tariff, transportation allowance, and the GRAVCAP ADJUSTMENT for gravity and sulfur.

B. FEA regulations (page 4940) part 212.72, paragraphs (2) and (3) with respect to new crude oil state:

"(2) Effective February 1, 1976, the total number of barrels of domestic crude oil produced and sold in a specific month, less (A) the property's base production control level for that month and less (B) the current cumulative deficiency since February 1, 1976; and

(3) Shall not in either period include any number of barrels not certified as new crude oil pursuant to the provisions of part 212.131(a)(1) within the consecutive two-month period immediately succeeding the month in which the crude oil is pro-

duced and sold, except where such recertification is explicitly required or permitted by FEA order, interpretation, or ruling."

Pages 4940 and 4941, part 212.74, paragraph (d) states as to retroactive increase in price that "No producer may charge or accept a retroactive increase in price for crude oil. Retroactive increase in price means any price charged or offered after the close of the calendar month in excess of the highest price prevailing for that grade of crude oil, in first sales between the producer and the purchaser of the domestic crude oil, during the calendar month in which it was produced and sold."

Enclosed is a copy of a letter dated March 18, 1976, from Standard Oil of California to our Alaska office, which shows *retroactive changes in royalties* due to a change in classification of oil from "old" to "new." This does not necessarily reflect a retroactive increase in price. Also enclosed is a copy of a letter dated March 5, 1976, from Mohawk Petroleum Corporation to our Alaska office, *objecting to retroactive adjustments* under their royalty oil contract and quoting the FEA regulations. The Alaska office has advised us that this matter with Mohawk has been resolved. We believe that most of our problems with prices and retroactive adjustments will be with the royalty oil purchasers. For example, transportation costs per barrel are determined from cost statements in a large number of cases after the total costs are determined for the calendar year. This requires retroactive adjustments to the value basis on which royalties are computed, and if the transportation costs are less than that previously allowed, we could be calculating royalties on a price in excess of the price allowed by FEA.

C. 30 CFR, part 225.a3, states that a charge for cost of administration of an account equal to one-half per-

cent of the market price will be made for each barrel of OSC royalty oil sold. We have been advised by an FEA auditor, that has been working in our Metairie office, that FEA considers the one-half percent additional charge as an increase in the price of oil under our royalty oil contracts, which may be in excess of the posted prices allowed by the current FEA regulations. The FEA auditor plans to make a report to FEA thereon.

D. To assist you in your review, some other information regarding the value basis for computing royalties follows and is enclosed for your ready reference:

1. Conservation Division Manual, Onshore Oil and Gas, Product Value—Oil and Condensate, dated May 17, 1974.
2. Director's Decision GS-60-O&G, dated October 11, 1974.
3. NOTICE to Lessees and Operators from the Tulsa Oil and Gas Supervisor, dated November 12, 1973.
4. Memorandum dated October 31, 1973, to the Conservation Managers, along with the Solicitor's memorandum of August 8, 1973.
5. IBLA 70-123 Decision of July 18, 1973.
6. Director's Decision GS-50-O&G, dated October 27, 1972.
7. Director's Decision GS-48-O&G, dated November 8, 1971.
8. Director's Decision GS-43-O&G, dated August 10, 1971.
9. Page from Mr. Dole's letter of January 26, 1971, to Mr. John Whittier of White House.

10. Letter of May 6, 1969, to Union Producing Company from Tulsa Oil and Gas Supervisor pertaining to tax reimbursement as being part of the gross proceeds.

11. Memorandum of October 7, 1965, to Tulsa Oil and Gas Supervisor from Chief, Branch of Oil and Gas Operations, with a subject "Tax reimbursements as an item comprising gross proceeds in sale of gas."

12. Solicitor's Decision A-29460, dated August 2, 1963.

13. Letter of February 8, 1963, to Honorable Bob Dole from Director.

14. Memorandum of November 8, 1961, to Tulsa Oil and Gas Supervisor from Chief, Branch of Oil and Gas Operations, together with incoming correspondence.

15. Old Branch of O&G Operations Manual, Chapter 3.1A(S47), dated March 31, 1961.

16. Director's Decision GS-22-O&G, dated May 20, 1957.

17. Memorandum of July 11, 1956, to Tulsa Oil and Gas Supervisor from Chief, Oil and Gas Leasing Branch.

18. Memorandum to Director, dated June 19, 1956, from Associate Solicitor.

19. Director's Decision GS-18-O&G, dated December 18, 1954.

20. Letter of July 26, 1941, from Acting Chief, Oil and Gas Leasing Division.

According to our Metairie office, a large number of lessees, operators, and royalty oil purchasers are paying royalties on prices that exceed the posted prices allowed

by FEA regulations. We do not plan to change our billing procedures until advised by your office on the foregoing.

RUSSELL S. WAYLAND
Chief, Conservation Division

Enclosures

cc: OS&D—Denver w/o encl. 1-20
Wyatt w/o encl. 1-20
Harris w/o encl.
Krahl w/o encl. 1/20

CD Files (GS-508-C)—MS 650
Desk Files (ABC-O) (WME)
WMHarris:ERWyatt:JDuletsky:kfn:04/16/76
860-7511

UNITED STATES
DEPARTMENT OF THE INTERIOR
OFFICE OF THE SOLICITOR
WASHINGTON, D.C. 20240

JUL 31 1976

Memorandum

To: Chief, Conservation Division, Geological Survey

From: Assistant Solicitor—Minerals, Division of Energy and Resources

Subject: Conflict Between Federal Energy Administration and Department of the Interior Regulations Regarding Oil and Condensate Royalty Valuation

Introduction

Sections 14 and 17(b) of the Mineral Leasing Act of 1920, 30 U.S.C. §§ 223, 226(b) (1970) and section 8(b)(3) of the Outer Continental Shelf Lands Act of 1953, 43 U.S.C. § 1337(b)(3) (1970), require that royalties be a certain percentage "in amount or value of the production" from the lease. The regulations implementing these statutes which govern the computation of royalties for oil and gas leases provide in part:

> The value of production, for the purpose of computing royalty shall be the estimated reasonable value of the product as determined by the supervisor, due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field, to the price received by the lessee, to posted prices and to other relevant matters. *Under no circumstances shall the value of production of any of said substances for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee*

> *from the sale thereof* or less than the value computed on such reasonable unit value as shall have been determined by the Secretary * * *. 30 CFR 221.47, 250.64. (Emphasis added)

The FEA regulations setting upper and lower tier price ceilings on crude oil provide in part:

> The prices charged for any sale of a covered product by any Federal department, agency, or other instrumentality, including any wholly owned Government corporation as defined in the Government Corporation Control Act of 1945, as amended, and by State and local governments are subject to the price regulations of this part * * *. 10 CFR 212.52, 41 F.E. 4939 (February 3, 1976).

[Portion of Memorandum Omitted by DOI Prior to Release]

"Gross Proceeds"

Within the context of 30 CFR 221.47 and 250.64, the term "gross proceeds" has been defined to mean:

> "[T]he established field price for the natural gas plus any additional sums paid by the purchaser of the gas to the unit operator as consideration for the purchase of gas from the unit of which the federal lease is a part." *Wheless Drilling Co.*, 80 I.D. 599, 603 (1973).

In *Wheless*, the Board of Land Appeals held that the Department properly charged royalties based on the price received by the lessee for its natural gas plus a partial reimbursement from the buyer to the lessee for the state severance tax paid by the lessee on the gas.

The *Wheless* case is consistent with an earlier departmental decision holding that gross proceeds include reimbursement by the buyer to the lessee of the lessee's share

of royalty due the United States arising from the [rest of copy missing; cut off page].

Kerr-McGee Oil Industries, Inc., 70 I.D. 464 (1963). The Secretary held in Kerr-McGee that "[w]ith the reimbursement provision they are receiving an additional compensation for the production of their leases." 70 I.D. at 470.

In a similar case, the Secretary affirmed a Geological Survey decision basing natural gas royalties on the entire price paid by the buyer to the lessee, in spite of the lessee's contractual obligation "to pay to the buyer, or to such other person as the buyer may direct, one cent per Mcf toward the cost of increasing the pressure of gas delivered to 500 psig prior to delivery into the buyer's main transmission facilities." *Big Piney Oil and Gas Co.*, A-29895 (July 27, 1964), at 2. The lessee unsuccessfully argued that the royalty should be based on the purchase price minus the repayment to the buyer for compression. Although the decision was based on a strict interpretation of the contract of sale rather than an interpretation of the term "gross proceeds", it nevertheless illustrates the general proposition that the United States is not bound by the actual price received by a lessee in establishing a value base for royalties, but rather is entitled to royalties based on the reasonable market value of the oil produced. *Cf. Continental Oil Co. v. United States*, 184 F.2d 802 (9th Cir. 1950); *Husky Oil Co.*, A-27168 (November 26, 1956).

[Portion of Memorandum Omitted by DOI Prior to Release]

Reconciling the Regulations

The general rule is that the provisions of varying statutes should be reconciled to the extent of any conflict. *Maiatico v. United States*, 302 F.2d 880 (D.C. Cir. 1967). *Cf. McGinnis Theaters v. Video Ind. Theatres, Inc.*, 262

F.Supp. 607.613-14 (M.D. Okla.), *aff'd*, 386 F.2d 592 (10th Cir. 1967), *cert. denied*, 390 U.S. 1014 (1968). If the conflicting provisions are irreconcilable, then the most recent prevails. *Inter-Continental Promotions, Inc. v. MacDonald*, 367 F.2d 293, 301 (5th Cir. 1966), *cert. denied*, 393 U.S. 834 (1968). These and other rules of statutory construction are equally applicable to administrative regulations. *Miller v. United States*, 294 U.S. 435 (1935); *Rucker v. Wabash R. Co.*, 418 F.2d 146 (7th Cir. 1969).

This approach follows the reasoning in *Mohawk Petroleum Corp. Inc. v. Department of the Navy*, 395 F.Supp 933 (C.D. Cal.), *aff'd* 521 F.2d 1394 (T.E.C.A. 1975). The *Mohawk* case involved a conflict between a provision of the Armed Forces Act, requiring that sales of oil and gas from naval oil reserves go to the highest qualified bidder (10 U.S.C. § 7430 (1970)), and the FEA price ceiling regulations (10 CFR Part 212). Mohawk sued to enjoin the Department of the Navy from selling oil to a company whose bid exceeded the ceiling price imposed by the FEA regulations. In issuing an injunction prohibiting the Navy from selling its oil at a price in excess of the FEA ceiling, the district court noted that there was no evidence of Congressional intent to exempt sales of crude oil from Naval reserves from price regulations promulgated under the Emergency Petroleum Allocation Act, 15 U.S.C. § 715 et seq. (1974 Supp.). 395 F. Supp., at 935. In addition, the court noted that 10 U.S.C. § 7430 is "an administrative provision respecting the determination of price on sales of crude oil and gas by the Navy, and as such is superseded by the price controls provided by the Emergency Petroleum Allocation Act and regulations pursuant thereto." *Id.* at 936.

In affirming the district court, the Temporary Emergency Court of Appeals observed that the imposition of FEA price controls on the sale of crude oil from Naval reserves did not frustrate the conservation, protection,

and testing of oil in the Naval Petroleum Reserve. 521 F.2d at 1395. As a result, to the extent that application of 10 U.S.C. § 7430 resulted in conflict with the FEA price ceilings, the FEA regulations were to prevail.

Conclusion

The Department of the Interior is charged with administering oil and gas leases on Federal lands and promoting the production and conservation of petroleum, at the same time reserving a royalty based on the value or amount of production from the lease. This purpose would not be frustrated by valuing royalty oil at a price not in excess of the ceiling set by the FEA regulations. This would not necessitate a complete redefinition of the term "gross proceeds," but rather would merely mean that if the gross proceeds received by a lessee were in excess of the FEA ceiling price, the value basis for the royalty would be the ceiling price. Otherwise, the royalty would be based on the gross proceeds received by the lessee.

Although the foregoing approach will result in technical violations of 30 CFR 221.47 and 250.64, it is not inconsistent with the statutory mandate to compute royalties from oil and gas production on the basis of the "amount or value of the production." 30 U.S.C. §§ 223, 225(b) (1970); 43 U.S.C. § 1337(b)(3) (1970). In addition, as the price ceilings change or are lifted entirely, the assessment of royalties based on the longstanding interpretation of "gross proceeds" can continue unimpaired, without the need for repeated redefinition of the term.

Frederick N. Ferguson

UNITED STATES
DEPARTMENT OF THE INTERIOR
OFFICE OF THE SOLICITOR
WASHINGTON, D.C. 20240

Memorandum August 23, 1976

To: Acting Chief, Conservation Division, Geological Survey

From: Assistant Solicitor—Minerals, Division of Energy and Resources

Subject: FEA regulations

We have reviewed the memorandum of July 16, 1976, from the Oil and Gas Supervisor, Production Control, Gulf of Mexico Area to the Acting Chief, Conservation Division concerning various conflicts between Federal Energy Administration (FEA) price regulations and Geological Survey royalty regulations and procedures.

The FEA regulations specifically provide that:

> The prices charged for any sale of a covered product by any Federal department, agency, or other instrumentality * * * are subject to the price regulations of this part * * *. 10 CFR 212.52

Thus, it would appear that to the extent that the Survey is involved in the sale of royalty oil, the valuation of and billing for that oil is subject to the FEA regulations. As we noted in our memorandum to the Chief, Conservation Division of July 30, 1976, the valuation of royalty oil cannot exceed the ceiling price set by the regulations.

Frederick N. Ferguson

May 5, 1977

MEMORANDUM FOR THE FILE

FROM: Carl A. Corrallo

SUBJECT: Meeting With U.S. Geological Survey Representatives

On May 2, 1977, Paul Bloom, Deputy General Counsel, and I met with representatives of the United States Geological Survey, including Ms. Karen A. Shaffer, a senior attorney from the Department of Interior, Office of the Solicitor. The meeting was called by Mr. Bloom to discuss the intentions of the U.S. Geological Survey and the Department of Interior with respect to their compliance with FEA regulations in the sale of royalty crude oil produced on leases owned by the federal government. Mr. Bloom explained to the U.S.G.S. representatives that certain information regarding U.S.G.S. had come to our attention by way of audits and investigation conducted by Region VI personnel in Louisiana and Texas and by way of U.S.G.S. involvement in the exceptions and appeals procedures associated with the payment of royalties to U.S.G.S. That information suggests that U.S.G.S. either did not consider itself to be subject to the jurisdiction of the Federal Energy Administration regulations or was disregarding the requirements of those regulations.

Specifically I pointed out that in sales of crude oil by U.S.G.S., the prices charged were in excess of the ceiling price. This was the result of U.S.G.S. calculating the price for such crude oil by reference to the average prices charged by the operator of the property from which the crude oil was produced and then adding a ½ percent fee to cover both transportation and administrative costs incurred in such sales. Further, notwithstanding our regulatory requirements that sellers of crude oil certify whether such crude oil is upper tier or lower tier crude oil, U.S.G.S. was providing estimates of the mix

of the crude oil they sold by reference to the mix of the property from which it was produced, without regard to any determination as to the classification of the particular crude oil being sold. In some cases, U.S.G.S. was providing no certifications at all. These violations appeared to be clear cut and extremently [sic] troublesome to FEA, given our mandate from the Congress to impose regulations on all crude oil produced in or imported into the United States.

Ms. Shaffer and U.S.G.S. representatives suggested that the mandate of the statute which provided the Secretary of Interior with the authority to administer federal oil leases clearly required that crude oil produced from such leases be "valued" with respect to the market prices and also required the recovery of certain administrative costs associated with the sale of such crude oil. They advised that U.S.G.S. took crude oil in kind to satisfy its royalty interests, although such transactions were on paper only, *i.e.* U.S.G.S. never took physical possession of the crude oil. In other circumstances, the operator merely pays U.S.G.S. a sum representing a 1/6 interest in the total proceeds received in the sale of the crude oil produced from the property.

U.S.G.S. suggested that this statutory authority of the Secretary of Interior displaced or superseded the authority vested in the President and the Administrator of the FEA by the Emergency Petroleum Allocation Act. Mr. Bloom and I took exception to this reading of the statute and indeed indicated quite strongly that it was our view that the Allocation Act imposed a requirement on the administration of these federal leases to conform with FEA regulations. We suggested that the distinction between the U.S.G.S. taking crude oil in kind as opposed to receiving a royalty interest payment was a meaningless one for the purposes of our regulations. Ms. Shaffer disagreed. She pointed out that in the case of the operator who had received exception relief in the form of per-

mission to certify certain volumes of lower tier oil as upper tier oil in order to garner sufficient revenues to economically maintain the operation, the statute and regulation required that operator to pay a portion of that increased revenue to the U.S.G.S. as royalty interest owner. This was notwithstanding that the exception relief afforded specifically excluded the royalty interest owners from participation in this relief. Ms. Shaffer was somewhat more hard pressed to justify her position with respect to U.S.G.S.'s sales of crude oil to third parties and indicated that she, after conversations with the other representatives, would reconsider the U.S.G.S. position with respect to FEA regulations and advise us of their decision. It was discussed and contemplated that this decision might eventually be made at a substantially higher level within both our organizations before the conflict could be completely and satisfactorily resolved.

[Portion of Memorandum Omitted by DOE Prior To Release]

FEDERAL ENERGY ADMINISTRATION

Jul. 6, 1977

Ms. Karen A. Shaffer
Department of Interior
Office of the Solicitor
Washington, D.C. 20240

Dear Ms. Shaffer:

On May 2, 1977, you and representatives of the United States Geological Survey ("USGS") met with me to discuss the apparent conflict between the USGS's practices in the sale of royalty crude oil produced on leases owned by the federal government and the requirements of FEA's crude producer price regulations. We engaged in a lengthy discussion in which you and I exchanged our perceptions of the requirements of the underlying statutes from which our respective agencies derive their authority and the applicable FEA and Interior Department regulations. Although no resolution of the conflicts between us was achieved, it was my understanding that you had agreed to reduce your position to writing and transmit that position to me. In this way we could begin the process of review of our respective legal views of this matter in order to eventually achieve a resolution of this conflict between USGS and FEA which continues to plague the enforcement operations of this agency. Unfortunately, I have yet to receive any such communication.

I cannot impress upon you enough the need for the conflict between our agencies to be resolved. If we are unable to expeditiously progress towards some resolution of this matter by an exchange of letters, I believe that the agency will have no choice but to proceed against the USGS in the context of a formal compliance action. While I do not perceive this as the most desirable method to approach this problem, I am nonetheless constrained by the man-

date of our enabling statutes to initiate some action against USGS. Please advise me as to your intentions in this matter so that FEA may determine its appropriate action with a complete understanding of your position.

Sincerely,

Paul Bloom
Deputy General Counsel

[SEAL]

UNITED STATES
DEPARTMENT OF THE INTERIOR
OFFICE OF THE SOLICITOR
Washington, D.C. 20240

Oct. 21, 1977

Memorandum of Law

Subject: The Secretary's power to modify his authority with regard to royalty on oil and gas to accommodate the FEA's policy objectives with regard to price regulation

This opinion is written in response to questions raised by the Federal Energy Administration (FEA), various federal oil and gas lessees, and refiners holding federal royalty oil contracts regarding the Department's collection of royalty pursuant to the Mineral Leasing Act of 1920 (30 U.S.C. §§ 181-287) and the OCS Lands Act (43 U.S.C. §§ 1331-1343).

The controversy between the FEA and the Department of the Interior has arisen, in the first instance, from attempts by the U.S. Geological Survey (USGS) to collect royalty due under federal onshore and offshore oil and gas leases and royalty oil contracts in accordance with statutes, the Secretary's regulations, lease terms, and royalty oil contracts. Fundamentally, FEA's position is that the lessees and refiners are released from certain royalty obligations on oil due to the overriding authority of FEA's price regulations. The FEA has advised federal lessees and refiners that they are so released. This advice has resulted in a number of appeals being filed by lessees and refiners with the USGS in protest of USGS's continuing attempts to collect royalty due under the lease terms, royalty oil contracts, and the Secretary's regulations.

The legal question raised by this conflict between the Department and FEA is whether the Secretary of the In-

terior may waive or modify his authority with regard to royalties on production from oil and gas leases issued pursuant to the Mineral Leasing Act of 1920 (30 U.S.C. §§ 181-287), the Mineral Leasing Act for Acquired Lands (30 U.S.C. §§ 351-359), and the OCS Lands Act (43 U.S.C. §§ 1331-1343), to accommodate the FEA Administrator's accomplishment of FEA's policies and objectives and exercise of his authority to establish ceiling prices for any first sale of crude oil produced in the United States pursuant to the Emergency Petroleum Allocation Act, as amended (15 U.S.C. § 751, *et seq.*).

The Secretary is charged with the responsibility for setting the royalty for oil and gas leases issued pursuant to section 8 of the OCS Lands Act (43 U.S.C. § 1337) at "not less than 12½ per centum in amount or value of the production saved, removed or sold." Similarly, under section 17 of the Mineral Leasing Act of 1920 (30 U.S.C. § 226), the Secretary is responsible for fixing the royalty for competitive leases issued pursuant to that section at "not less than 12½ per centum in amount or value of the production removed or sold from the lease." [1] For purposes of simplicity, we will assume a royalty rate of 12½ per centum throughout this opinion. This constitutes the Secretary's basic statutory authority for the collection of royalty and the authority through which the Secretary determines the production upon which royalty accrues and the value of that production for royalty purposes. By statute, the Secretary is also responsible for the sale of royalty oil (taken in kind or "amount") (30 U.S.C. § 192; 43 U.S.C. § 1334) and for granting relief to lessees from royalty requirements (30 U.S.C. § 209; 43 U.S.C. § 1334).

As far as all these royalty functions are concerned, there is no indication in the Emergency Petroleum Allocation

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[1] Under 30 U.S.C. § 226, the royalty rate for noncompetitive leases is fixed at 12½ per centum.

Act (EPAA), 15 U.S.C. §§ 751-756, as amended by the Energy Policy and Conservation Act (EPCA), 89 Stat. 871, 941, that the statutory obligations of the Secretary with respect to royalty have been substantively, modified or transferred to the FEA's jurisdiction except as provided in the Department of Energy Organization Act (91 Stat. 565).[2] However, it is clear that the authority of the FEA Administrator to establish ceiling prices applicable to any first sale of crude oil in the United States (Sec. 8 EPAA, 89 Stat. 942) has a bearing on the Secretary's valuation of oil for royalty purposes.

At this point, a closer examination of the Secretary's statutory obligations with respect to the administration of the royalty requirements is in order.

Specifically, there are at least four identifiable points of controversy which are addressed individually in this memorandum: (1) the production on which royalty accrues, (2) the valuation of production when royalty is taken "in amount or value," (3) the timing of adjustments to billings for royalty, and (4) the administrative charge collected from refiners when royalty is taken in kind.

PRODUCTION ON WHICH ROYALTY ACCRUES

The key statutory provisions are those mentioned above which provide for a royalty of 12½ per centum in "amount or value" of production saved, removed or sold from the lease. In the Solicitor's Opinion of October 4, 1976 (M-36888) and addenda thereto (M-36888 Supp. I and Supp. II) interpreting the royalty provisions of the Mineral Leasing Act and the OCS Lands Act, the Solicitor concluded that royalty is due on all production, i.e., all oil or gas withdrawn from a reservoir. (Copy attached) The Solicitor concluded that this interpretation is com-

[2] The effect of the transfer of functions under this Act is discussed in the latter portion of this opinion.

pelled by the statutes. (*See, Effect of October 4, 1976 Solicitor's Opinion M-36888*, March 9, 1977, M-36888 Supp. II.) Thus, when royalty is taken in amount or value, as the statutes provide, the royalty accruing to the United States is not less than 12½ percent of the value or the amount of *all* oil or gas withdrawn from the reservoir. *See, The Texas Company*, A-22010, January 15, 1953.

By decision dated January 26, 1977 (FEA-0850 and FEA-0926), the FEA purports effectively to permit a federal onshore oil and gas lessee, M. J. Mitchell, to sell 76.66 percent of his production at upper tier prices, the remainder at lower tier prices, and allow him to pay royalty to the United States as if his entire production were sold at lower tier prices. This decision, if allowed to stand, would result in the lessee paying royalty on less than the value of the entire production, thereby reducing the amount of royalty payable to the United States on production from the lease by approximately one-half. We think the holding of the FEA with respect to the payment of royalty oil is beyond the jurisdiction of the FEA and results in the payment of royalty on a basis contrary to that required by statute. Further, we believe the Secretary would not be properly performing his statutory duties with regard to royalty should he accept the outcome of the FEA decision.

When taken in money, our view of the statutory requirements is that the royalty must be based on the value of the *entire production*, not just 23.34 percent of it. Valuation is discussed below, but for purposes of the example contained in the next sentence, we will assume price equals value. So, if the Secretary were to value the entire production as if it were all sold at the lower tier price as FEA would require, the United States would receive approximately one-half the royalty it would receive if valuation were based upon the actual value or sales price of the entire production, i.e., valuing 77.66

percent at the upper tier price and 23.34 percent at the lower tier price. Attached is a chart demonstrating the principle.

It is important to understand how the FEA reached the conclusion it did in the *Mitchell* case. On April 2, 1976, the FEA granted M. J. Mitchell exception relief from the provisions of 10 CFR Part 212, Subpart D (which establishes the ceiling price for old crude oil) and thereby permitted him to sell 76.66 percent of the crude oil produced from the Minnelusa Sand Unit in the Pickrel Ranch Field, Campbell County, Wyoming, at upper tier prices. (*M. J. Mitchell*, 3 FEA Par. 83,146 (April 2, 1976)). The relief was granted because Mitchell could not continue economically to operate the unit if compelled to sell the oil production at lower tier prices. The decision purported to limit the exception relief to the working interest owners only and to forbid royalty interest owners from basing their royalty share on the increased value of the production. The reason for doing so was expressed in terms of economics:

> Consequently, the objectives of maintaining an economic incentive to continue production from a property would not appear to be furthered by approving exception relief for the royalty interest owners, who have neither incurred increased costs nor experienced an economic disincentive to maintain production. (at 7)

This decision and statement indicates a misconception on FEA's part of the nature of the United States' royalty interest, the requirements of existing law with regard to royalty, and the authority of the FEA over royalty in general and to grant royalty relief in particular.

FEA's explanation of its actions contained in its appeal decision [3] sheds further light on the misunderstanding be-

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[3] FEA-0850, FEA-0926 Decision and Order of the Federal Energy Administration, January 26, 1977 [hereinafter, Appeal Decision].

tween FEA's and the Department's authority. It is clear from the decision (at 4) that FEA's chief concern was with the achievement of its statutory duty to

> establish ceiling prices (or the manner of determining ceiling prices) applicable to any first sale of crude oil produced in the United States, such that the resulting actual weighted average first sale price for all such crude oil during such calendar month . . . shall not exceed a maximum of $7.66 per barrel . . . . Sec. 8(a) EPAA, 89 Stat. 942.

The granting of relief to Mitchell was clearly in conformance with FEA's statutory authority to grant price relief when necessary to take into account declining production and to provide an incentive to obtain optimum production (Sec. 8(b) (2), EPAA, 89 Stat. 942). However, in granting the price relief, the FEA also purported to grant royalty relief based on the view that (1) the United States only takes royalty in kind and thus is not affected, (2) the royalty interest owner has no operating expenses, therefore it does not qualify for exception relief, (3) if the United States based its royalty share on the increased value of the production, the effectiveness of FEA's relief to the operator would be diminished and the achievement of Congressional policy objectives would be thwarted. The latter would occur because FEA would have to permit more of the oil to be sold at upper tier prices to provide the operator with effective relief from operating costs, of which FEA viewed royalty to be a part.

The FEA's decision is based upon a number of assumptions about its legal authority which override what we view as statutory obligations the Secretary may not relinquish or modify. What follows is an examination of those assumptions.

1. The first assumption that the FEA makes in its decision is a factual one:

> As a general matter royalty owners have an actual interest only in the *crude oil* produced from their properties rather than in the *proceeds* which accrue to the working interest owner from the sale of the crude oil production. Consequently, most lease agreements assess a royalty based upon a fraction of the total production of crude oil rather than upon revenue actually accruing to the working interest owner. (emphasis added)

It is well established that the language "in amount or value" as contained in section 17 of the Mineral Leasing Act of 1920 (30 U.S.C. § 226) and section 8 of the OCS Lands Act (43 U.S.C. § 1337) provides the Secretary of the Interior with the authority and the option to take royalty in amount or in value at his discretion. This view is further borne out by section 36 of the Mineral Leasing Act (30 U.S.C. § 192) which provides "all royalty accruing to the United States under any oil or gas lease or permit under this title *on demand* of the Secretary of the Interior shall be paid in oil or gas." (emphasis added) Standard oil and gas lease terms for federal lands generally reflect the position that royalty is taken in kind or in value at the Secretary's option. Therefore, contrary to the FEA's assertion that the ruling in the *Mitchell* decision would not adversely affect the United States as a royalty interest owner because royalty is taken in kind, it is clear that the United States' interest may be and often is taken in value and thus is clearly affected by the ruling in the FEA decision. This is so since, as we have explained earlier, the amount of royalty accruing to the United States pursuant to the FEA decision when taken in value is nearly one-half the amount of royalty it would normally collect in accordance with the statutory requirements of the Mineral Leasing Act and the OCS Lands Act, the Secretary's regulations, and the lease terms.

In essence, the FEA makes two legal assumptions, one explicitly and one implicitly. The explicit assumption is that the FEA has the authority to modify the terms of an oil and gas *lease* which prevent the accomplishment of the policy objectives set forth by the Congress in the Emergency Petroleum Allocation Act of 1973, as amended. The implicit assumption is that the FEA also has the authority to modify the terms of the *statute* providing for royalty of "12½ per centum of the amount or value of the production of oil and gas removed or sold" from a federal oil and gas lease.

We believe that the FEA's authority in the first instance is limited to specific situations outlined by Congress in the EPAA.

For its conclusion in the *Mitchell* decision that the FEA may breach a contract in the interest of pursuing the objectives of section 4 of the EPAA, the FEA relied upon section 6(c)(5).[4] That section provides:

> There shall be available as a defense to any action brought under the antitrust laws, or for breach of contract in any Federal or State court arising out of delay or failure to provide, sell, or offer for sale or exchange crude oil, residual fuel oil, or any refined petroleum product, that such delay or failure was caused solely by compliance with the provisions of this chapter or with the regulation or any order under section 753 of this title.[5]

Section 753 is section 4 of the EPAA and basically provides the authority for the FEA to achieve certain Con-

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[4] Appeal Decision, at 4.

[5] Section 6(c)(5) was broadened in the amendments to the EPAA by deleting reference to the antitrust laws and amending the phrase "under section 753 of this title" to read "under this Act." The analysis we make herein remains unaffected by the change.

gressional policy objectives which are spelled out in that section.

It is important to note that section 6(c)(5) limits the authority of the FEA to breach a contract only in regard to the provision for failure to offer for sale or exchange crude oil, residual fuel oil or any refined petroleum product. In other words, the section goes to the question of delivery of oil, not to the question of breaching a contract in such a manner as to breach the royalty obligation owed by the lessee to the royalty interest owner, particularly to the United States.

Thus, the FEA's pursuit of objectives spelled out in section 4 of the EPAA does not justify the breach of contracts in every instance, but only in instances involving the delivery of oil.

Clearly the achievement of the Congressional policy objectives in section 4 of the EPAA cannot be used in such a broad sense as to provide a reason for, in effect, abrogating federal lease terms which reexpress the statutory option of the Secretary to take royalty in kind or in value. Hence, FEA's explicit assertion that the FEA may by regulation supersede the statutory obligations of the Secretary of the Interior must be based on some other grounds than the EPAA statutory provisions for the breach of contracts.

The question raised is whether Congress intended its delegation of authority to the President (then to the FEA Administrator under the EPAA) and listing of policy objectives and prescription of his duties in the EPAA, as amended, to supersede the obligation of the Secretary of the Interior with regard to royalty as set forth in the Mineral Leasing Act of 1920 and the OCS Lands Act. Congress explicitly provided in section 6 of the EPAA for a declaration of the impact of the EPAA on other laws. Preemption is discussed with respect to state or local allocation regulations and orders, actions taken un-

der the Economic Stabilization Act of 1970, and the relationship of the antitrust laws to the enactment of the EPAA. However, there is no discussion in the EPAA as to the effect of this law on the Mineral Leasing Act of 1920 or the OCS Lands Act.

It is a well-known rule of statutory construction that where two statutes seemingly deal with the same subject matter, they should be read insofar as possible to be consistent with each other and not to permit the implied repeal of the earlier law. There is no indication in the EPAA, as amended, that the statutory obligations under the Mineral Leasing Act of 1920 and the OCS Lands Act with regard to royalty accruing to the United States on federal oil and gas leases are modified by the provisions in the EPAA, as amended, which give the President the authority to allocate crude oil and regulate the prices thereof in accordance with economically related objectives of insuring the appropriate allocation and pricing of oil nationally.

Therefore, we do not believe that the FEA Administrator may by regulation modify the statutory provisions of the Mineral Leasing Act of 1920 and the OCS Lands Act which require the performance of certain royalty functions. It is our view that the authority of the Secretary under the Mineral Leasing Act of 1920 and the OCS Lands Act with regard to royalty is compatible with the exercise of the FEA Administrator's authority to allocate oil and to establish ceiling prices therefor.

2. The second assumption of the FEA decision in the *Mitchell* case relates to the production on which royalty accrues and the valuation of that production for royalty purposes. The ruling in the *Mitchell* case mostly affects the United States' royalty share when royalty is taken in value at the option of the Secretary. We have already discussed our view that when royalty is taken in value or in amount that the royalty accrues on all production,

or in other words, all oil and gas withdrawn from the reservoir. When taken in value, this means that royalty, by the terms of the statute, is due on the value of all the production. As we pointed out earlier, the Secretary is compelled by the statute to collect royalty in this manner. The effect of the FEA decision is to prevent the Secretary from carrying forward his statutory obligations. This is because, as we have seen, royalty under the *Mitchell* decision would have to be calculated at the value attributable to 23.34 percent of the production. This is contrary to the statutory directive to collect royalty on the value of all production, even though the Secretary has the discretion to establish a reasonable value of the production under both the Mineral Leasing Act of 1920 and the OCS Lands Act. *United States v. Ohio Oil Co.*, 163 F.2d 633, 639-641 (10 Cir. 1947).

Thus, the holding of the FEA in the *Mitchell* case permitting the lessee to pay royalty to the United States as if its entire production were sold at lower tier prices is not in accordance with the dictates of the Mineral Leasing Act. In our view, the statute requires that royalty be based on the value of the entire production, not just the value attributable to 23.34 percent of it. A discussion of the valuation of production appears later in this paper.

3. The argument the FEA makes in its *Mitchell* decision that the royalty interest owner has no operating expenses and therefore does not qualify for exception relief is not relevant to the issue at hand. The statutory royalty obligations of the Secretary are separate from the lessee's obligations under the statute and the lease to develop his lease and produce oil and gas. The FEA's view reflects a clear misunderstanding of the nature of the royalty interest held by the United States. Royalty payments are consideration for the taking of oil or gas once a lease has reached production status. By statute, without the payment of royalty called for by the lease, the lessee's rights under the lease are subject to cancellation.

Royalty is not merely an operating expense, but the foundation for the contractual right to produce oil or gas owned by the United States.[6]

4. The fourth assumption is that the FEA, when considering granting price relief to a lessee, has authority effectively to reduce the royalty obligation of the lessee. It is true that the ability of the lessee to pay royalty is related to the price he can obtain for his production and his operating expenses. But statutorily the royalty obligation set forth in the Mineral Leasing Act and the OCS Lands Act is separate from the regulation of prices by the FEA. The FEA has no statutory authority to regulate or limit the royalty interest of the United States in attempting to reach its price regulation obligations.

It is clearly conceivable that a lessee's operations could become so marginal that the amount of royalty accruing to the United States would make a difference in whether or not he could continue to produce oil or gas. Since oil prices became regulated under the EPAA, as amended, two remedies have become available to the lessee for relief in this situation. The first remedy is to seek price relief from the FEA. The price relief may be based upon consideration of operating expenses including the royalty obligation. However, the only form of relief FEA may offer is an increase in prices or volume of oil which may be sold at the upper tier prices tailored to meet the operator's specific needs.

The royalty obligation itself may be *reduced* only by the Secretary of the Interior pursuant to specific provisions of the Mineral Leasing Act and the OCS Lands Act (30 U.S.C. § 209; 43 U.S.C. § 1334). Thus, a second and

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[6] "*Royalty Expense* represents the percentage of the gross receipts which a producer must pay to the landowner for the privilege of extracting from the reserves underlying his land." *Shell Oil Company v. Federal Power Commission*, 520 F.2d 1061, 1068 (5th Cir. 1975).

separate remedy is provided a lessee whose operations have become marginal. Although the FEA argues in the *Mitchell* case that permitting the United States to base its royalty share on the increased value of the production would decrease the effectiveness of FEA's price relief to the operator because the operator's royalty obligation would be increased accordingly, the appropriate remedy provided by law to the operator for relief from the increased burden is to request relief under 30 U.S.C. § 209 or 43 U.S.C. § 1334, from the Secretary of the Interior. Making full use of these provisions, FEA need not feel that it is compelled because of the additional royalty burden to thereby grant a greater increase in prices or increase in the amount of production for which it grants exception relief. On the other hand, FEA could achieve its economic incentive objectives by considering the incremental royalty cost to the producer in the computation of price relief.

We find no authority for the view that the FEA or the Secretary of the Interior may, by regulation, modify the explicit provisions giving the Secretary authority to reduce royalty which are contained in section 39 of the Mineral Leasing Act (30 U.S.C. § 209):

> The Secretary of the Interior, for the purpose of encouraging the greatest ultimate recovery of coal, oil, gas, . . . and in the interest of conservation of natural resources, is authorized to waive, suspend, or reduce the rental, or minimum royalty, or reduce the royalty on an entire leasehold . . . whenever in his judgment it is necessary to do so in order to promote development or whenever in his judgment the leases cannot be successfully operated under the terms provided therein.

The position taken by the FEA in the *Mitchell* case that the FEA's authority to regulate price includes the authority to control the amount of royalty paid to the

United States is similar to the position it took in the case of *Shell Oil Company v. Federal Energy Administration, et al.*, 400 F.Supp. 964 (S.D. Texas, 1975). In that case, the FEA asserted it had the authority to regulate rents charged to service station operators on the theory that rents are so inextricably interwoven with prices paid for gasoline that regulation of prices would be frustrated unless the FEA also had the authority to control the rents charged. The court disagreed. It held that the FEA could regulate prices and that rents are not prices (p. 970). Neither are royalty values prices.

VALUATION OF PRODUCTION

The valuation of production for royalty purposes is clearly a matter within the Secretary's discretion. *United States v. Ohio Oil Co.*, 163 F.2d 633, 639-641 (10th Cir. 1947); *Continental Oil Co. v. United States*, 184 F.2d 802, 821 (9th Cir. 1950); *California Company v. Seaton*, 187 F.Supp. 445, 449-450, 453 (D. D.C. 1960); *California Company v. Udall*, 296 F.2d 384, 388 (D.C. Cir. 1961). However, even the Secretary's exercise of his authority to value production for royalty purposes is limited by court interpretation of the term "value" as meaning "true value" or "market value" of the production. In *Continental Oil Co. v. United States, supra*, the court interpreted the term "value," as it appears in the Mineral Leasing Act in the phrase "amount or value of the production" and as it is carried forward in the lease, as requiring royalty to be based upon "actual, true or market value of the oil." In *California Company v. Udall, supra*, the court stated that "value" means "fair market value."

In *California Company v. Seaton, supra*, after noting the term "value" as it appears in the phrase "in amount or value of production" is not defined in the Act and the legislative history of the Act is not helpful in defining the term, the court stated that "value" in the context in

which it appears in the Mineral Leasing Act generally means "estimated or assessed worth" or "marketable price." The court further indicated that on various occasions other courts have held that value ordinarily means market value, fair market value or market value fairly determined.

While the courts continually have upheld the Secretary's discretion to determine the value of production under the Mineral Leasing Act, the courts have gone further and established that it is reasonable for the Secretary to conclude that production generally is worth, for purposes of valuation of royalty, what the lessee is able to realize therefrom. *Continental Oil Company, supra* at 821. The Secretary, through his regulations, has established the minimum value of production for royalty purposes at no less than the gross proceeds accruing to the lessee from the sale of that production. (30 CFR 221.47 [7] onshore, 30 CFR 250.64 offshore)

Hence, the most reasonable interpretation that can be found of the meaning of the term "value" within the context of the royalty provisions of the Mineral Leasing

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[7] 30 CFR § 221.47—"Value basis for computing royalties. The value of production, for the purpose of computing royalty shall be the estimated reasonable value of the product as determined by the supervisor, due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field, to the price received by the lessee, to posted prices and to other relevant matters. Under no circumstances shall the value of production of any of said substances for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee from the sale thereof or less than the value computed on such reasonable unit value as shall have been determined by the Secretary. In the absence of good reason to the contrary, value computed on the basis of the highest price per barrel, thousand cubic feet, or gallon paid or offered at the same time of production in a fair and open market for the major portion of like-quality oil, gas, or other products produced and sold from the field or area where the leased lands are situated will be considered to be a reasonable value."

Act and the OCS Lands Act is that the Secretary is obligated to value production based upon the actual, true or market value of the oil or gas produced. It is further reasonable to conclude that the actual, true or market value will be in any case no less than the gross proceeds accruing to the lessee from the sale thereof. The Secretary's regulations setting forth the Department's standards on the value basis for computing royalty (30 CFR 221.47 onshore) were found by the court in *California Company v. Seaton*, *supra* at 450, to be consistent with the Mineral Leasing Act and to be reasonable within these legal parameters. There is no indication in the Emergency Petroleum Allocation Act that the FEA Administrator has authority which permits him by regulation to release the Secretary of the Interior from this obligation.

For the phrase "in amount or value of production" to be read and interpreted in accordance with the foregoing discussion, we must conclude (1) that royalty is due on all production and that all production must be valued for royalty purposes, and (2) the value of that production must be based upon the actual, true or market value of the production and in any case no less than the gross proceeds accruing to the lessee from the sale thereof.

Although Congress delegated to the President, and thus to the FEA, the authority to regulate the price at which oil may be sold, the Secretary continues to have the authority to value oil or gas for royalty purposes. Congress has neither expressly nor impliedly granted the latter authority to the FEA. We have already established, through statutory construction, why we think the FEA's authority over price is separate from the Secretary's statutory obligations with regard to royalty. However, the FEA, in essence, appears to take the position that "value" can only be interpreted as meaning the FEA price. The FEA position assumes two things: (1) the statutory obligations established by the EPAA

override the statutory provisions of the Mineral Leasing Act and the OCS Lands Act, and (2) the regulated price equals royalty value.

The first assumption has been examined a good deal already. However, an explanation of the parallel situation with the FPC which relates to both assumptions is in order. In *Mobil Oil Corporation v. Federal Power Commission*, 463 F.2d 256 (D.C. Cir. 1972), *cert. denied*, 406 U.S. 976 (1972), FPC Order and Opinion No. 562, 42 FPC 164, determined and declared that the royalty provisions of oil and gas leases constitute sales of natural gas for resale in interstate commerce subject to the Natural Gas Act because the landowners contracted to retain an economic interest in interstate sales. Thus, the landowners were declared to be subject to regulation as natural gas companies whose sales are covered by the filings of their lessees, the producer-operators.

The court reversed the FPC's Opinion, finding that the lessor who has no authority to determine the incidents of sale, although he retains an economic interest, is *not a seller*. Hence, on leases which required royalty based on current "market price" of gas, the court considered the question whether an increase of royalty payments due resulting from increased value of production first has to have express prior approval of the FPC, if the price thus fixed would exceed levels prescribed by the FPC. The court ruled there was no legal impediment to producers being held on the basis of a contract to a royalty payment related to a base higher than the producer's filed rate. The court additionally found that no evidence had been presented which would lead it to believe that the federal regulatory system would be undercut by its ruling.

The situation in the *Mobil* case has its parallel in the dispute between the FEA and this Department. The 1975 amendments to the EPAA provide the President with the

authority to establish ceiling prices applicable to any first sale of crude oil produced in the United States. (Section 8(a)) The United States, as royalty owner, when it takes royalty in value does not "sell" the crude oil produced by the lessee although it retains an economic interest in the sale thereof. Thus, the "value" of the production for royalty purposes is a matter apart from the price of the production for purposes of sale.

Therefore, the FEA, like the FPC, has no jurisdiction over the valuation of production for royalty purposes. But more importantly, apart from jurisdictional disputes, the price regulation is a separate statutory function from royalty, which has its own statutory requirements. No matter who has jurisdiction, the statutory requirements must be administered as separate from one another, although complementary. The statement made by Judge Leventhal in the *Mobil* case, *supra* at 263, regarding the FPC's ruling that it had jurisdiction over royalty owners is equally applicable to this situation

> If the statutory use of "seller" or "sale" of natural gas in interstate commerce is referable to the meaning of these words in ordinary usage, or as likely understood by Congress, the FPC's ruling is clearly unsound. We do not think a different result warranted or mandated on the ground that the purpose of the Act is to protect the ultimate beneficiaries against exploitation by natural gas companies. That was indeed the objective of Congress, see *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610, 64 S.Ct. 281, 88 L.Ed. 333 (1944). The FPC is to be commended for attempting to further that objective, but it is not sufficient justification upon which to base an expansion of the Act to activities clearly not within its terms. Congress did not give the FPC carte blanche to take whatever action it might consider appropriate in furtherance of this purpose. The FPC is limited by the provision establishing its juris-

> diction, and we do not find in that provision, rooted as it is in a sale in interstate commerce, any basis for reaching out to cover the landowner's lease or its royalty payments.

In the valuation of production for royalty purposes, the Department shares the court's view, expressed in the *Mobil* case, that the regulated price does not necessarily equal the royalty value when the latter is to be based upon current "market price." However, the Department, in acknowledgement of the fact of a regulated market, as a matter of policy and practice, generally honors the FPC prices in the case of gas, and the FEA prices in the case of oil, condensates and liquids, as the base value of the production for royalty purposes.

The starting point for computing royalties is the current posted area price bulletins that accord with FEA regulations. However, where the lessee obtains additional consideration for the sale of its product due to transportation clauses in the sales contracts or other factors, the USGS will calculate royalty on the regulated price basis, adjusted to reflect the additional value. This is because value of production is deemed to be no less than the gross proceeds accruing to the lessee from the sale thereof. *Kerr-McGee Oil Industries, Inc., et al.*, 70 I.D. 464; *Amoco Production Co.*, IBLA 77-18 (March 25, 1977). On the other hand, where the lessee has obtained an approved transportation allowance, the USGS will calculate royalty on the regulated price basis, adjusted downward to reflect the authorized transportation deduction.

Department regulations for both offshore (30 CFR 250.64) and onshore (30 CFR 221.47) state that the value, for the purpose of computing royalty, shall be the estimated reasonable value of the product as determined by the Supervisor, due consideration being given to the highest price paid for a part or for a majority of production of like quantity in the same field or area, to the price

received by the lessee, to posted prices, and to other relevant matters. Under no circumstances shall the value of production of any of said substances for the purpose of computing royalty be deemed to be *less than the gross proceeds accruing to the lessee* from the sale thereof or less than the value computed on such reasonable unit value as shall have been determined by the Secretary.

As pointed out earlier, court decisions uphold this standard for the valuation of production for royalty purposes. This standard is used for royalty calculations whether taken in amount or in value. The applicable standard for taking royalty in kind may be stated as follows: The value of royalty oil is based on the highest price that would have been legally obtainable by the lessee if royalties on production were being paid by the lessee rather than being taken in kind. (30 CFR 225.2(f) and 225a.2 (i))

The Secretary elects to take the royalty on oil production in kind as a matter of policy to make government royalty oil available to eligible or small refiners when sufficient supplies of crude oil are not available in the open market to refiners not having their own source of supply for crude oil. 30 U.S.C. § 192. "Eligible" or "small" refiners are owners of existing refineries who qualify as small business enterprises under the rules of the Small Business Administration. (30 CFR 225.2a onshore, 30 CFR 225a.2a offshore)

Pursuant to 30 U.S.C. § 192 and 43 U.S.C. § 1334, the Secretary's authority to sell royalty oil is limited to sale "at no less than the market price." "Market price" is defined by the Department's regulations, 30 CFR 225.2 onshore and 225a.2 offshore in the following way:

> (i) "Market price" means (1) the highest price per barrel regularly posted, published, or generally paid, or offered by any principal purchaser of crude oil of like quality in the field or area where produced, or

> (2) if there are no postings in the field or area, the highest price posted in the nearest field or area where crude oil of comparable quality is produced and sold, or (3) the true value as determined by the Supervisor when in his judgment such highest price regularly posted, published, or generally paid or offered in the same field or area or the nearest field or area is found by him to be less than the true value of the royalty oil. *In no event shall the "market price" be less than the estimated reasonable value which the Supervisor would determine as the value of production, pursuant to § 250.64 of this chapter, if royalties on the production in question were being paid in money by the lessee rather than being paid or taken in kind.* (30 CFR 250a.2) (emphasis added)

Clearly, in the regulated market, the "highest price per barrel regularly posted" is generally the posted price as limited by the FEA. The USGS, in valuing royalty oil, honors the FEA price. The royalty oil is sold at the FEA price. However, the amount the refiner may owe the United States under the royalty oil contract may in some instances exceed or be less than the FEA price due to adjustments for transportation costs.

These adjustments are based upon the view that the United States should receive the same royalty value whether the royalty on production is taken in kind or in value. If the value of production for royalty purposes is one thing for the lessee when he sells it, then the value for the United States when it sells the oil should be the same. The United States should receive no less than the lessee would receive when selling the same product.

BILLING ADJUSTMENTS

FEA regulations, in essence, require the certification to the purchaser of the volume and regulated type of crude oil and a statement that the price charged for the oil is

no greater than the maximum price permitted pursuant to FEA regulations (10 CFR 212.131). The certification for new crude oil is to be provided within "the consecutive two-month period immediately succeeding the month in which the crude oil is produced and sold . . . ." (10 CFR 212.72). After such time, FEA regulations do not permit upward adjustments to billings to the refiner-purchaser of royalty oil. However, the FEA regulations do not limit the time within which refunds due to overbillings may be made. We do not believe the Secretary may abide by FEA regulations regarding certification (10 CFR 212.313 and 212.72) where such regulations circumscribe the Secretary's duty to collect royalty in accordance with the Mineral Leasing Act of 1920 and the OCS Lands Act.

When the Secretary elects to take the United States' royalty on oil production in kind, the following reporting and accounting procedures are observed with respect to the sale. For our purposes here, we will trace the reporting and accounting procedures as they would occur for the sale of royalty oil produced offshore, taking June as the production month for our example. Onshore procedural differences are noted where appropriate. We will also assume that a small refiner has entered into a standard three year royalty oil contract with the United States.

Throughout the production month of June, the lessee, having received notice from the Supervisor, delivers a portion of that production to the refiner at the previously agreed upon delivery point. Although the Supervisor determines in advance that the refiner is entitled to fixed amounts of royalty oil for that month, the actual volume of oil delivered to the refiner that month may be less or greater than the entitlement.

The lessee is required by regulation (30 CFR 221.62, onshore and 250.94 offshore) to submit a Monthly Report

of Sales and Royalty, Form 9-153 (Form 9-361 onshore), for each month of production. The offshore report is due by the last day of the first month following the month of sales (July 31). Onshore, the report is due on or before the tenth day of the second month following the month of sales (August 10). The time for submission of these reports is the earliest practicable time by which a lessee can account for monthly production. On this form the lessee reports on a lease basis the volume of production and the disposition of that production for the month. The volume of oil sold and the prices at which the oil was sold are indicated. Offshore, when royalty is taken in kind, the lessee indicates the value of the monthly production. This value is based upon the posted price in the field as limited by the FEA and adjustments for transportation as provided for in Department regulations. This reported royalty value assume. that the refiner actually received the exact monthly entitlement of royalty oil.

Sometimes, the lessee does not report accurate figures. This may occur for several reasons. If the lessee's lease is committed to a Unit, his data showing the amount of production allocated to his lease may be incorrect. Onshore, the lessee may have made an incorrect well count when calculating production subject to royalty. Sometimes, the lessee is uncertain about the applicable FEA price. Calculation errors are also possible.

By Department regulation, the refiner is required to have some form of bond coverage for the royalty oil purchases. The usual bond coverage is for 90 days, although these bonds may also be executed for 30 or 60 days. For purposes of our example, we will assume 90-day bond coverage.

The United States Geological Survey (USGS) sends the refiner an "estimated billing" for the June production month no later than the 15th day following the last day of the month of production, July 15. This billing is

based upon historical take calculated from the figures submitted by the lessee in his Report on Sales and Royalty for the previous month's production (May or April). The amount billed is payable within 30 days from the end of the production month, i.e. by July 31. In light of the bond coverage or posted surety, this estimated billing is timed to protect the interests of the United States in guaranteed payment for its royalty oil. By August 15, another estimated billing will have gone to the refiner containing a billing for July production.

In the meantime, the June Report of Sales and Royalty has been reviewed for completeness by the USGS Area Accounting Section, typed for automatic data processing, and forwarded to the USGS at Reston, Virginia for entry into the lease account. A computerized Statement of Account, Form 9-1424, is then mailed to the Area Office about 60 days after the production month, i.e. August 30. The Statement of Account shows the volume and disposition of oil produced for the production month. It indicates the volume sold and the net value. The net value is based upon the FEA price at which the oil was sold, adjusted for transportation costs. The net value is the value reported by the lessee and should be, in any case, no less than and no more than the estimated reasonable value which the Supervisor would determine as the value of production if royalties on the production in question were being paid by the lessee rather than being taken in kind. The Statement of Account is used offshore as the final corrected billing for the June production and is sent by USGS to the refiner. The Statement of Account for the lessee additionally reflects the total volume and value of the royalty oil that was taken in kind by the refiner.

Onshore, the Statement of Account is further adjusted by the Area Accountants to reflect corrections reported after the data had gone into the computer. Thus, onshore, the USGS sends the refiner and the lessee what is

called the "Actual Letter" which is considered as the final corrected billing. This letter goes out to the refiner usually 15-20 days after the Area Office's receipt of the Statement of Account, i.e. September 15-20.

Accompanying the Actual Letter is a standard form entitled "Report on Upper Tier and Lower Tier Oil." This report is the most accurate statement available to the USGS of the volumes of upper tier and lower tier oil delivered during the production month and the FEA weighted average prices for that oil. It also states the values of the oil for royalty purposes. This report has been used by the USGS since May 15, 1975 onshore and was orally found acceptable by the FEA to be used in place of the certification required by FEA regulations (10 CFR 212.131). Although the offshore supervisors were instructed to use this form, we have discovered that the form has not been used offshore. The USGS has recently reinstructed the offshore supervisors to use the form and it will shortly be sent out in conjunction with the Statements of Account to the refiners.

The report is not a certification of the amount and value of the oil delivered during the production month. This is because the USGS never has physical control over the oil at any time during the royalty oil sale transaction. The USGS report is based upon information, of necessity, supplied by the lessee in its Monthly Report of Sales and Royalty submitted 30-40 days after the production month. The report (on upper tier and lower tier oil) is only as accurate as the lessee's figures upon which it is essentially based. These figures reflecting volumes, sale prices, and royalty values of production, are subject to and frequently are corrected by the lessee or by the USGS pursuant to an audit months after delivery of the royalty oil. The Secretary cannot certify in good faith that these are the correct figures; rather, he can only report the best figures he has at the time. This is also why the USGS cannot comply with FEA regulations es-

tablishing the 60-day period from the month of production as the date beyond which the Secretary may not collect additional royalty due the United States.

Legally, we think the Secretary may not be lawfully bound by the 60-day requirement or the certification requirement. The Secretary's statutory duty to collect royalty on all production and to sell royalty taken in kind at no less than the market price may not be circumscribed by regulations which, through time constraints or certification, prevent him from obtaining the "market price" on an accurately determined volume of production. His authority to collect the proper royalty due the United States may be circumscribed only by statute. In this regard, he is limited in his time for collection of proper royalties by the statute of limitations. (Federal Claims Collection Act of 1966, 31 U.S.C. § 951-953). (*See, Continental Oil Company v. United States, supra*, to the effect that the Secretary may collect back royalties where royalty had been paid on a basis of less than the true value.) He may not be limited further by the FEA unless specific statutory authority can be found to modify the Mineral Leasing Act and OCS Lands Act by authorizing the FEA to regulate the collection of royalty due the United States. Such authority is clearly lacking. (Although in *California v. Simon*, 504 F.2d 430 (TECA 1974) the court considered the procedural basis for FEA's rescission of state and local government exemption from FEA price controls for oil produced on state and locally owned land, which also removed the Federal Government exemption, the substantive merits were not considered.)

Even if the FEA had the authority, the FEA regulations in this regard are clearly unreasonable and arbitrary as to the United States. For example, while the Secretary may not bill refiners for higher royalty based on corrected accounts after the 60-day period, he evidently may refund or credit overpayments made by refiners

at any time. It should be noted that the USGS regularly grants refunds or credits to the refiner where adjustment of accounts 60 days after the production month indicates overpayment due to overbilling.

Clearly, this regulatory scheme works against the interest of the United States as a matter of policy. It also is arbitrary in that it gives less latitude for collection of royalty due to underbilling than to refunds due to overbilling. Perhaps this constraint makes sense for producers who sell their own oil directly to a refinery or pipeline. These producers have more opportunity for control of data and producing operations. However, the United States must rely upon reporting by its lessees while its lessees control actual production and delivery. Hence, the 60-day requirement constrains the party least able to control factors which are essential to achieve compliance.

If the Secretary honored the 60-day restriction and the certification, the United States would lose millions of dollars in royalty revenue each year. The result would probably lead the Secretary to conclude as a matter of policy that it is no longer in the interest of the United States to take royalty on oil production in kind. The Secretary would cease selling royalty oil to eligible refiners. The only other alternative would be for the Secretary to increase the estimated billings to refiners by a fairly large percentage to insure there would never be any underpayments by refiners. The Secretary would then be able to make appropriate refunds or credits.

ADMINISTRATIVE CHARGE

FEA contests the authority of the Secretary to charge the refiner for the cost of administration of the royalty oil sale of an amount equal to one-half percent of the market price for each barrel of royalty oil sold. (30 CFR 225.3 onshore and 225a.3 offshore). The Secretary's

authority for charging the refiner has been based upon 31 U.S.C. § 483a. That section provides that a federal agency head may by regulation prescribe a fee, taking into consideration the direct and indirect cost to the government, the value to the recipient, public policy or interest saved, for any work performed or benefit granted by the federal agency. The Secretary's regulations providing for the charge to the refiner are based upon the fact that the entirely separate, complex system required for accounting for royalty oil sales is an additional burden to the government not otherwise incurred when royalty is taken in value. Also, the royalty oil sales are currently designed to meet the need of small refiners for supplies of crude oil which such refiners cannot obtain any other way. Thus, the charge also takes into consideration the value of the benefit received by the refiner.

Since the Federal Land Policy and Management Act (FLPMA) became law on October 21, 1976 (90 Stat. 2743), the Secretary is specifically authorized under Section 304 to establish reasonable charges with respect to applications and other documents relating to the public lands to reimburse the United States for reasonable costs incurred. The Secretary is instructed by this law to take into consideration factors similar to those mentioned in 31 U.S.C. § 483a. We think the Secretary has clear statutory authority to assess the refiner for administrative costs, and we think his exercise of this authority is reasonable under the circumstances.

However, since the collection of an administrative charge is not required by statute, the Secretary is in a position to accommodate FEA by dropping the charge. Perhaps this matter would best be resolved by the Office of Management and Budget.

TRANSFER OF FUNCTIONS

It is appropriate to note here that Section 302(b) of the Department of Energy Organization Act (91 Stat. 565) transfers certain royalty functions of the Secretary of the Interior to the Secretary of the Department of Energy. Section 302(b)(5) provides:

> (b) There are hereby transferred to, and vested in, the Secretary the functions of the Secretary of the Interior to prescribe regulations under the Outer Continental Shelf Lands Act, the Mineral Lands Leasing Act, the Mineral Leasing Act for Acquired Lands . . . which relate to the . . .
>
> (5) specifying the procedure, terms, and conditions for the acquisition and disposition of Federal royalty interests taken in kind.

It is not clear from this language whether the Secretary of Energy may prescribe regulations dealing with the valuation of royalty oil, since the statute speaks of prescribing "procedures, terms and conditions" for its "acquisition and disposition." It seems clear that the quoted language relates to the eligibility of refiners to obtain federal royalty oil and the system by which such royalty oil is allocated among eligible refiners. If the new Secretary's authority also includes the power to prescribe royalty oil contract terms, valuation of royalty oil may be included as a part of that function.

In any case, the valuation for royalty purposes of oil taken in kind and the accounting procedures by which the proper royalty is collected must continue to be performed in accordance with the statutes pursuant to which these functions are authorized.

With this regard, the Secretary of Energy, by the transfer of authority, inherits the same statutory obligations the Secretary of the Interior has under the Mineral Leasing Act and the OCS Lands Act. The fact that the same

Secretary will have authority over both prices for the sale of crude oil and perhaps also valuation of royalty oil, including accounting procedures, does not mean that the two functions lose the separate statutory constraints which arise out of their separate statutory origins, however interrelated the two functions may be.

Therefore, the views we have expressed in this opinion are not altered by the transfer of functions pursuant to the Department of Energy Organization Act. We believe any new regulations devised by the Secretary of Energy should reflect cognizance of the statutory constraints and obligations we have discussed in this opinion.

We are aware that the Secretary of Energy may be placed in a conflicting policy role by the transfer of functions under Section 302(b)(5); however, we believe that conflicts can be minimized through cooperation between those in this Department charged with administration of royalty matters, the Conservation Division of the U.S. Geological Survey, and those charged with regulation authority in the Department of Energy.

LEO M. KRULITZ

Solicitor

May 2, 1978

MEMORANDUM FOR: Robert Walter
Director, Leasing Program Office
Peggy Halpern
Litigation Division
Office of General Counsel

FROM: Bryan Perilman
Compliance Division
Office of General Counsel

SUBJECT: Proposed Draft NOPV to USGS

Pursuant to our meeting today, please find attached a rough draft copy of a proposed NOPV which ERA is considering issuing to USGS. The draft has not been modified as yet to incorporate the new procedural requirements under the PRO system (10 C.F.R. 205.150 *et seq.*).

Please note also that the draft has not yet been officially accepted by ERA and is subject to further modification. Any suggestions you have, of course, are welcome.

Feel free to call me if you have any questions regarding this draft. I am enclosing several copies for you to distribute to those at the meeting who work in or with your offices.

Attachment

OGC:BPerilman:bld:Rm.5388:2000":x43700:2May78

[SEAL]

Oct. 1, 1979

Department of Energy
Washington, D.C. 20461

MEMORANDUM FOR BARTON ISENBERG
Assistant Administrator for
Enforcement
Economic Regulatory Administration

FROM: Robert D. Gerring
Director for Program Operations
Office of Enforcement

SUBJECT: U.S. Geological Survey

A great deal of rhetoric has transpired regarding whether the crude producer regulations should be enforced with regards to sales by the U.S. Geological Survey.

On the surface, it is a case of whether or not the Department of Energy (DOE) should extract refunds from another goverment agency when, ultimately, at least a portion of the refunds may remain in a government account. The situation is more serious and complex than the above statement. The specific question is this: "Is the U.S. Geological Survey exempt from duly authorized laws, whereby it can sell its crude oil at any price it desires, or must it abide by the regulations as set forth by other Federal agencies?"

According to information supplied by L.K. Jones, the Survey does not operate any of its own leases. Rather, it receives royalties in kind from the lease operators, which it sells on its own accord. As the crude oil is produced from Federally-owned land, no other royalties are paid. In the past, it has been alleged that crude oil has been sold in excess of maximum legal ceiling prices.

Furthermore, in most cases, it has refused to provide certifications concerning the correct tier of oil it is sell-

ing. The policy of challenging the Department of Energy's authority to regulate energy by governments, i.e. Federal, State, and city, is becoming more prevalent. Recently, the States of Wyoming and Louisiana have questioned the authority of the supplier/purchaser rule and have directed that oil produced in those States will remain in those States. In addition, relationships have been terminated unilaterally.

It is my belief that we should meet with the U.S. Geological Survey to discuss all aspects of the case and propose that compliance with the regulations on a current basis take place. If we do not receive cooperation from the Survey, we should take appropriate action to recover overcharges and establish compliance with current regulations.

Tom Holleran, Wayne Tucker, and myself are available to discuss the matter with you.

cc: W Tucker
T Holleran

HAND DELIVERED

Department of Energy
Washington, D.C. 20461

October 25, 1979

Mr. Kenneth Lee
Office of the Solicitor
U.S. Department of the Interior
Washington, D.C.

Dear Mr. Lee:

Attached is a brief summary of six enforcement issues involving practices of the U.S. Geological Survey. It is requested that you review these issues, and let Mr. William Pendergrass of my staff know if you would like to meet with him on Friday morning, October 26, at 10:00 a.m., to discuss these issues in advance of a meeting between members of the Office of the Solicitor and the Office of the General Counsel. You may reach Mr. Pendergrass at (202) 254-8700.

Sincerely,

Robert G. Heiss
Assistant General Counsel
for Enforcement

Attachment

cc: John Leshy
Larry McBride

BRIEF SUMMARY OF SIX ENFORCEMENT ISSUES INVOLVING PRACTICES OF USGS

USGS sales of royalty oil without certification of volumes of upper and lower tiers of crude oil

10 CFR § 212.131 requires, *inter alia*, that the producer certify in domestic crude oil sales, the volumes of lower-tier ("old") crude oil and upper-tier ("new") crude oil. USGS apparently billed one purchaser of royalty oil for crude oil sold in the first four months of 1975, without certifying any volumes of upper-tier oil. The lower-tier price was approximately $5.35 during that period, but USGS billings appear to have exceeded the lower-tier price by approximately $450,000, exclusive of interest.

USGS sales of royalty oil without regard to the property's BPCL

With regard to an offshore lease, USGS apparently sold royalty oil at exempt prices prior to February 1, 1976, and at upper-tier prices subsequently, without regard to BPCL, in violation of 10 CFR § 212.73. USGS apparently computed the selling price of royalty oil using a "ratio" method for the month of production, as follows:

$$\text{Selling Price per barrel} = \frac{\text{Gross proceeds from all production accruing to lessee(s)}}{\text{All production from lease (barrels)}}$$

USGS sales of royalty oil based upon recertifications of crude oil outside the two-month period required by 10 CFR 212.72 and 212.131

10 CFR § 212.73(a) limits a producer's pricing of a "first sale" to the lower-tier ceiling price except for "new" crude oil (defined in § 212.74). Furthermore, 10 CFR § 212.72 (and § 212.131) provides that new crude

oil shall not include oil that is not certified as new crude oil within the consecutive two-month period immediately succeeding the month in which the crude oil is produced and sold. USGS allegedly charged a price to a purchaser of royalty oil, Young Refining Corp., based upon volumes of crude oil that had not been certified or recertified as "new" or "upper-tier" crude oil within the two-month period required by 10 CFR §§ 212.72 and 212.131, resulting in an overcharge of $127,819.25, exclusive of interest, for sales applicable to the months of September and October 1976. In addition, another purchaser has identified $71,220.04 in alleged overcharges that have resulted from untimely recertifications of crude oil by USGS in June 1975 and January and February 1977.

USGS sales of royalty oil at "stripper well" prices based upon inclusion of injection wells in the number of wells used to determine average daily production

USGS has apparently sold royalty oil at "stripper well" prices by determining average daily production based upon the inclusion of injection wells, in violation of 10 CFR § 212.54, as interpreted by Ruling 1974-29 and DOE's Notice of Enforcement of 10 CFR § 212.54 as Interpreted by Ruling 1974-29 (March 23, 1978). DOE has excluded injection wells from the determination of a property's average daily production, since those wells are not considered as wells which "produce" crude petroleum. One purchaser has alleged that the USGS overcharge for one month, August 1979, for sales of royalty oil at "stripper well" prices based upon inclusion of injection wells in determining average daily production, was $1,112,500.

USGS sales of condensate produced from gas wells as "stripper well" exempt crude oil

As stated in Ruling 1974-28, a firm may not properly claim "stripper well" exempt status for the natural gas

or condensate production of "gas wells" on a property, since these wells do not produce crude petroleum. See 10 C.F.R. § 210.32, now deleted. Investigation of an offshore property disclosed that gas wells which produced condensate were improperly classified as "stripper wells", and, as a result, USGS charged uncontrolled prices for the royalty oil produced and sold from the property, in alleged violation of 10 CFR § 212.73.

USGS' failure to maintain records

Economic Regulatory Administration auditors have noted that USGS records are apparently, in several areas, not maintained in accordance with the requirements set forth in 10 CFR § 212.128(a) and (c). Specifically, it appears that USGS has failed to: compute each property's base production control level, document the highest posted prices used to determine sales of upper-tier and lower-tier crude oil from each property, produce records, on a well-by-well basis, of production from stripper well properties.

In Reply Refer To:

EGS-MS640

24 May

Memorandum

To: Associate Solicitor—Energy and Resources

From: Deputy Division Chief, Offshore Minerals Regulation Conservation Division

Subject: Request for a refund of $17,359,883.88 by Lakeon Asphalt Refining, Inc., in connection with royalty oil sales by the USGS

In a memorandum dated October 21, 1977, the Solicitor took the position that, in connection with royalty oil sales, the USGS was not required to comply with certification and pricing regulations issued by the Department of Energy. On at least one occasion the Department of Justice suggested that our position was not legally defensible.

Under the circumstances, please let us know whether we should defer to the view of the Department of Justice in this matter.

ROBERT L. RIOUX

cc: CD/FORP/640
DDC/Offshore
Desk File (Eva Datz)
BORP Chrons
OFF/MR Chrons

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DRAFT

Memorandum

To: Assistant Solicitor, Offshore Minerals and International Law

From: John H. Kelly, Staff Attorney

Subject: Solicitor's Memorandum of October 21, 1977

This responds to your request for a review of the above memorandum to determine if it is legally supportable. A copy of the memorandum is attached for your reference.

Two of the three conflicts between DOE and DOI discussed in the memorandum have been resolved by DOE regulations. Effective March 13, 1980, DOE provided in 10 C.F.R. § 212.74(d) that OCS royalty oil could be sold for a price that exceeded the ceiling price by one-half percent. Survey was thereby authorized to assess its one-half percent administrative charge on OCS royalty oil. Further, DOE had earlier proposed regulations (10 C.F.R. § 391.210(a)(2), 44 *Fed. Reg.* 45,900, 45,908 (August 3, 1979)), that would allow an administration charge of one-half percent for onshore royalty oil sales but these regulations were not published in final form due to uncertainty regarding the effects of the decision in *Plateau Inc. v. Department of the Interior*, 603 F.2d 161 (10th Cir. 1979) on standards to be used in the sale of onshore royalty oil. Also effective March 13, 1980, DOE provided in 10 C.F.R. § 212.74(e) that in those cases where price relief is granted a producer, the royalty owner is entitled to the same relief. This regulation allowed Survey to base its royalty rate on the actual price received by the producer, not on the regulated price, and represented a reversal of DOE's position in *M. J. Mitchell*, 3 FEA Par. 83, 146 (April 2, 1976). As indicated above, the conclusions reached by the memoran-

dum regarding the issues of the administrative charge and price relief are no longer in conflict with those of DOE. Such conclusions are legally supportable and have been affirmed by DOE's regulations.

The third conflict between DOE and DOI discussed in the memorandum is DOI compliance with DOE regulations regarding certification. The memorandum concludes that DOI is not required to comply with these regulations for the reason that they circumscribe the Secretary's duty to collect royalty in accordance with the Mineral Leasing Act of 1920 and the OCS Lands Act. These regulations require that certification of new crude oil is to be provided within 60 days after the month in which the oil is sold. 10 C.F.R. § 212.72(d); 10 C.F.R. § 212.131(a). They also prohibit charging retroactive price increases after the period of certification (10 C.F.R. § 212.74(c)) and are applicable to sales of oil by "any Federal department, agency, or other instrumentality . . . ." 10 C.F.R. § 212.52. The memorandum does not assert that the certification regulations are not authorized by statute. The position taken by the memorandum appears to be that while the regulations are authorized, they cannot legally be applied to the Survey because Survey cannot comply with them without losing royalty revenue. The memorandum contains several statements of law and fact which deserve attention. First, it is stated at page 18:

> We do not believe the Secretary may abide by FEA [DOE] regulations regarding certification (10 C.F.R. § 212.313 [sic] and 212.72) where such regulations circumscribe the Secretary's duty to collect royalty in accordance with the Mineral Leasing Act of 1920 and the OCS Lands Act.

The basic problem posed by the above statement is whether the regulations actually "circumscribe the Secretary's duty to collect royalty." The memorandum